



**Economic Impact Assessment of Section 481
Film Relief
December 2012**



An Roinn Airgeadais
Department of Finance



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Economic Impact Assessment of Section 481 Film Relief

Final Report

December 2012

Fiscal Division
Department of Finance
Government Buildings, Upper Merrion Street, Dublin 2
Ireland
Tel: +353 1 6767571
Fax: +353 1 6789936
Website: www.taxpolicy.gov.ie

Preface

This Economic Impact Assessment Report was prepared by the Economic Division in the Department of Finance.

The authors Brendan O'Connor and Terence Hynes would like to acknowledge the valuable input and assistance from Department of Finance colleagues in the Economics and Fiscal Division, as well staff in the Incentives and Statistics Division of the Revenue Commissioners, the Central Expenditure and Evaluation Unit of the Department of Public Expenditure and Reform, the Department of Arts Heritage and the Gaeltacht, the Irish Film Board and members of the Tax Strategy Group.

Organisations and individuals were invited to submit their views as part of a public consultation process which ran from 28 May to 31 August 2012. Twenty responses were received. This high level of engagement by members of the public and a variety of organisations is gratefully acknowledged.

The work of BDO and Amárach, who carried out a review of audiovisual incentives in other States and a survey of domestic and international production companies, is gratefully acknowledged. The BDO and Amárach studies are published as annexes to this report.

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Executive Summary, Conclusions and Policy Options

Background

- 0.1 The tax relief for investment in film, television and animation productions ("Section 481") has been in existence in various formats since 1987. The exchequer contribution to the sector has been substantial with approximately €46.5m in tax foregone in 2011 from the Section 481 relief as well as €13.1m direct exchequer funding through the Irish Film Board.
- 0.2 The scheme has been subject to a number of government and external reviews, the most recent of which was a Department of Finance review in 2007 and a review by the Commission on Taxation in 2009.
- 0.3 In light of the recommendation by the Commission on Taxation that the relief should be subject to regular review and a recommendation by 'Creative Capital' a joint Government-industry group, that the relief should be extended to 2020, it is timely to subject the relief to a rigorous economic assessment and cost benefit analysis.
- 0.4 The relief has recently been extended by the Minister for Finance until 2015. Given the multi-year lead in time for production and financing and the level of international competition from tax and non-tax offerings by competitor jurisdictions, certainty regarding the post 2015 situation is of the utmost importance.
- 0.5 This review looks at the impact of the relief in terms of the volume and value of productions supported by Section 481, the number of jobs associated with Section 481 investments and the cost to the exchequer. The review also studies the tax and non-tax State supports in competitor jurisdictions and considers the economic impacts of the relief in Ireland through an analysis of the efficiency, effectiveness and equity of the scheme. It also includes an analysis of the full economic costs and benefits to society of the scheme through a cost benefit analysis model.

The review

- 0.6 The review had four key pillars:
 - Consultation: A consultation process with interested parties was initiated following the publication of a consultation paper on 25 May 2012. Twenty parties responded to the paper by making submissions to the Department.¹ The views expressed during the consultation have helped the Department's understanding of the issues.
 - International review: Following a competitive tender, the Department appointed the international accounting, tax and professional services firm BDO to conduct a review of tax and non-tax incentives offered in ten competitor jurisdictions. The BDO study has informed the Department's understanding of the international environment.
 - Survey of audiovisual producers: Following a competitive tender the Department appointed the market research and analytics firm Amárach,

¹ All responses to the consultation process are published on the Department of Finance's tax policy website www taxpolicy.gov.ie

in partnership with BDO, to conduct a survey and interview series with domestic and international production companies that have used Section 481. The data collected by BDO/Amárach and issues raised by parties is presented throughout this report.

- Economic analysis and cost benefit study: The Department of Finance’s economics division analysed the efficiency, effectiveness and equity of the scheme as currently structured and conducted a full cost benefit analysis of the overall societal impacts of the scheme on the basis of the CBA model used by the State’s industrial development agencies. The economic analysis benefited from considerable input and assistance from colleagues in the Revenue Commissioners who provided extensive access to case file data.

0.7 The final reports of BDO and Amárach and the Department’s CBA model are published as annexes to this report.

Key findings of the review

0.8 In 2011 Section 481 supported 57 productions with approximately €118m in eligible expenditure supported through the scheme. Whilst the overall expenditure levels in that year were down on record levels of 2010 - due in part to the production of the international TV drama Camelot - the expenditure levels in 2011 were the second highest recorded in the seven year period 2005-2011.

0.9 There was a higher volume of domestic productions in 2011 with 38 recorded compared with 19 incoming productions; however the levels of expenditure have been consistently greater from incoming productions. Overall incoming TV drama accounted for the highest per production expenditure level for each of the years 2008-2011. The impact of incoming productions is significant given the level of competition in this space as evidenced in the BDO report and the importance of State supports internationally.

| | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | Total |
|-------------------------------|------|------|------|------|------|-------|------|-------|
| Numbers of Productions | | | | | | | | |
| Incoming | 11 | 15 | 16 | 14 | 14 | 28 | 19 | 117 |
| Domestic | 15 | 23 | 18 | 24 | 29 | 29 | 38 | 176 |
| Total Expenditure | | | | | | | | |
| Incoming | €26m | €58m | €66m | €58m | €58m | €129m | €61m | €456m |
| Domestic | €31m | €55m | €52m | €51m | €47m | €35m | €57m | €329m |

Table 1: Volume and value of incoming and domestic productions, 2005-2011

Source: Revenue Commissioners, Irish Film Board

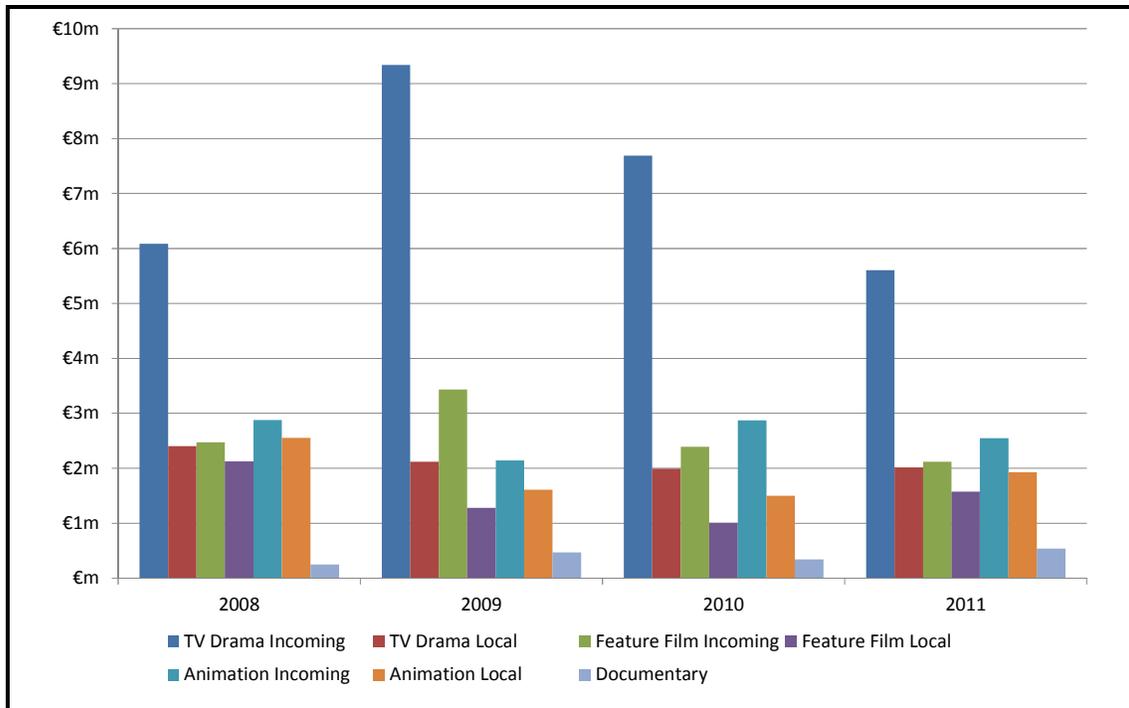


Figure 1: Per production expenditure 2008-2011

Source: Revenue Commissioners, Irish Film Board

- 0.10 The impact of Section 481 productions is also represented by the estimated 1600 full time equivalent (FTE) jobs in Section 481 productions in 2011. The tax contributions of these employees and audiovisual productions in general are considered in the cost benefit analysis.
- 0.11 The BDO review examined the tax and non-tax incentives offered to audiovisual production in ten key competitor jurisdictions. It identified three types of incentives: investor led incentives; producer based incentives, and direct grant based incentives.
- 0.12 The Irish model is an investor led incentive as the relief is provided as a relief against income tax to investors. The BDO review found that Ireland and Belgium are outliers in this approach to audiovisual support with the most common form of support being a producer led support which offers a direct tax credit to the production company.
- 0.13 Amongst tax incentives, the Irish model has one of the highest net benefits to producers with a 28% net benefit comparing favourably with a 20% net benefit in the UK for productions under £20m (€25m) and a 12.8% for productions in excess of £20m according to HMRC guidance.
- 0.14 Another key benefit of the Irish model is the up-front nature of the benefit to the production company. Most producer led tax credit models are in the form of ex-post benefits, a view that was also expressed in the responses to the consultation and in response to the BDO survey and interview modules. Whilst a number of models have emerged for the early monetisation of an ex-post tax credit, they broadly involve some element of discounting.

- 0.15 Whilst the existing scheme does generate undoubted benefits to the sector, an economic analysis of the efficiency, effectiveness, and equity of the scheme identifies certain weaknesses.
- 0.16 Despite a headline rate of relief of 41%, the ultimate benefit to production companies is 28%, suggesting a significant leakage at approximately 13% of Section 481 funds raised (32% of the overall exchequer cost). This leakage which is accounted for by professional fees and investor remuneration is difficult to justify given the current constraints faced by the exchequer.
- 0.17 The scheme appears to be very low risk to investors, and is typically marketed as such. In addition the returns can be relatively high, in some instances up to 23% of investor equity, with remuneration typically received within the year of investment. While investors do bear production risk the Department has not been made aware of any instances of production failures in recent years. On a risk-adjusted return basis there is a genuine economic concern that Section 481 investments may crowd out other equity based investments in the economy including other equity based tax incentive schemes (for example the Employment and Investment Incentive Scheme).
- 0.18 The main participants in the scheme are high income individuals with 74% of investors in 2010 having income in excess of €100,000. The structure of the scheme is also inequitable as investor remuneration is dependent on the individual having a substantial portion of their income at the higher rate of income tax, an issue that was previously identified by the Commission on Taxation as a barrier to participation by lower income individuals.
- 0.19 In terms of the overall impact to society, the Department's Economics Division modelled the economic costs and benefits using a model developed for the appraisal of industrial development projects by Forfás and which is consistent with official guidance by the Department of Public Expenditure and Reform. The model was populated with data from Revenue case files.
- 0.20 The Department's cost benefit model estimates a substantial net welfare loss to society from the scheme. An analysis of the sensitivity of this finding to changes in some of the key parameters and inputs shows that the scheme would only generate a gain under extreme scenarios which are considered implausible and inconsistent with official guidelines on cost benefit analysis.

Policy options

- 0.21 There appear to be three options for decision:
- Abolish Section 481;
 - Maintain Section 481 in its current form; or,
 - Change Section 481 in light of the findings of the review.
- 0.22 The importance of tax incentives for audiovisual production was made clear by respondents to the consultation. The analysis during the review also identified the importance of incoming productions to the sector in terms of overall expenditure as well as the competitive nature of tax supports offered internationally. The mobile nature of incoming productions and the offerings available in other jurisdictions would result in substantial reduction in activity in the absence of some form of support.

- 0.23 However maintaining Section 481 in its current format does not appear to be sustainable. The scheme as currently operated fails a cost benefit analysis, has a high level of inefficiency in terms of leakage and is inequitable due to its reliance on high income individuals which itself is inconsistent with Government commitments to 'cap or abolish tax shelters which benefit very high income earners'.
- 0.24 It therefore appears necessary to reform Section 481 in a way which maintains investment in Ireland by incoming productions, supports growth in the sector to 2020, improves equity and efficiency, and reduces the exchequer cost.
- 0.25 In line with international practice, and in light of the analysis presented in the review, it is recommended that Ireland moves towards a producer led tax credit model based on the net benefit to producers under the current scheme. In order to maintain a similar level of benefit and avoid the need to discount the relief by borrowing against the credit from a financial institution, a payable credit could be delivered by Revenue after a minimum level of expenditure is complete. The exact mechanics of the timing of the credit and administrative controls to protect the exchequer from fraud should be a matter for consultation between Department of Finance officials, Revenue and the industry.
- 0.26 This approach would enhance the efficiency of the scheme and lower the exchequer cost while maintaining a similar level of benefit to producers. This model would also remove high income individuals from the funding model, thereby improving equity. It would be hoped that high income individuals instead invest in other equity investments in the State including tax incentive equity based schemes.
- 0.27 It is acknowledged that this approach would place production risk onto the production companies rather than on tax investors as is currently the case. However after almost twenty-five years of State support, and no cases of production failures in recent years, it appears reasonable that production companies would assume this risk.
- 0.28 If such a model were in place in 2011, it would have resulted in a 32% exchequer saving. Based on the same level of qualifying expenditure this would have reduced the exchequer cost from €46.5m to €32m as the rate of relief would have been at 28% (in line with the producer benefit) rather than 41% (at the investor's marginal income tax rate). This saving would also have improved the outcome of the cost benefit analysis.
- 0.29 Finally it is recommended that the change be introduced gradually in order to facilitate a transition within the industry to the new funding model.

1. Introduction

- 1.1 Section 481 of the Taxes Consolidation Act 1997, otherwise known as the film relief, is a tax incentive for the audiovisual sector which covers investment in film, television and animation productions that are produced in the State.
- 1.2 The incentive has existed in various formats since the 1980s and is intended to contribute to the development and sustainability of the Irish film/screen industry which is viewed as a strategic cultural industry supporting domestic jobs and the tourism sector in Ireland.
- 1.3 A key change in the scheme in 1993 allowed for investment by individual investors and was the template for the current incentive.
- 1.4 The scheme itself has been reviewed by Government Departments on a number of occasions, most recently by the Department of Finance in 2007, and was also examined by the Commission on Taxation in 2009 who recommended that the relief should be subject to regular review.
- 1.5 The programme for Government, "*Government for National Recovery 2011-2016*", committed to reducing capping or abolishing tax shelters which benefit very high income earners.
- 1.6 Finance Act 2011 provided for an extension of the scheme to the end of 2015. It is now deemed appropriate to review the scheme in the context of making timely decisions regarding the future of the scheme after 2015.
- 1.7 In line with the recommendations of the Commission on Taxation and Government policy in relation to tax reliefs the Department of Finance has undertaken an economic impact assessment with a view to determining if the scheme is still necessary and to understand the consequences of possible modifications and changes.
- 1.8 The terms of reference for this review, which involve the evaluation of the tax expenditure scheme in broad socio-economic and fiscal terms, and the determination of the extent to which the scheme justifies its continuation, are summarised in the Box below.

- Examination of the costs and benefits of the existing scheme, taking into account displacement/deadweight impacts, and the interplay between this and other tax reliefs
- The identification of value for money of the scheme to the economy overall
- Examination of the international competitiveness context within which the sector operates
- Recommendations, where and if necessary, for changes that could be made to enhance / maximise the value for money to the tax payer and sustainable job creation and taking digital production and technological advances into account.

Box 1: Terms of Reference

- 1.9 Organisations and individuals were invited to submit their views as part of a public consultation process which ran from 28 May to 31 July 2012.² To assist this process the Department published a consultation paper on 25 May 2012. The paper set out the terms of reference of the review and posed a number of consultation questions.
- 1.10 Twenty responses were received from various bodies including production companies, representative bodies, advisory firms and others. This high level of engagement by members of the public and a variety of organisations is gratefully acknowledged.
- 1.11 The Department's economic analysis benefited greatly from access provided on a confidential basis by Revenue to its case files and tax receipt data. A team from the Department's economics division spent a two week period gathering data on exchequer receipts from Revenue's files and systems. This data was a primary input to the Department's cost-benefit modelling. The assistance provided by Revenue officials throughout the review has been indispensable.
- 1.12 This Report presents the final economic impact assessment report and contains the conclusions and recommendations that have emerged following the public consultation and economic analysis and modelling.

Structure of the Economic Impact Assessment Report

- 1.13 The next chapter describes the history of the scheme, its various iterations, as well as previous reviews by government departments and other bodies.
- 1.14 *Chapter 3* looks at data on Section 481 productions from the Revenue Commissioners, the Irish Film Board and other bodies. The chapter presents the costs to the exchequer as well as data on production expenditure and employment.
- 1.15 *Chapter 4* discusses the outcome of the public consultation process and includes a summary of submissions received. The chapter also discusses the key themes that emerged.
- 1.16 *Chapter 5* looks at how the scheme operates in practice. The chapter describes the various activities that are covered by the scheme, how the scheme is marketed, the types of investors that participate and the typical financing model.
- 1.17 *Chapter 6* describes the outcomes from the survey and interview work conducted on behalf of the Department by Amárach and BDO with domestic and international audiovisual producers.
- 1.18 *Chapter 7* describes the outcome of the review of tax and non-tax incentives offered to the audiovisual sector in other jurisdictions. The Chapter also describes recent developments in the UK and EU.
- 1.19 *Chapter 8* presents the outcome of the Department's cost benefit analysis.
- 1.20 *Chapter 9* presents possible policy proposals based on the outcomes of the consultation, the consultancy studies and the cost benefit analysis.

² On foot of requests from interested parties the consultation period was extended to 31 August 2012

2. Review of Section 481

- 2.1 This chapter looks at the background to Section 481 including the various iterations the scheme has gone through over time, how it operates at present and the activities covered by the scheme today.
- 2.2 There is also a discussion on other State supports for the audiovisual sector and previous reviews of Section 481.

History

- 2.3 The Section 481 which is in operation today has its origins in the introduction of the business expansion scheme (BES) in 1984, which allowed individuals to claim tax relief on annual investments in designated enterprise sectors, including film production. The BES scheme allowed an investor to receive tax relief on investment in eligible shares of a qualifying company, where the money raised was to be used for the carrying on of a qualifying trade.
- 2.4 The BES provision for the film sector was replaced by Section 35 of the Finance Act 1987. This provision related to investments by 'investor companies' made in qualifying films and an upper investment limit of £100,000 per annum applied (€127,000) which was later increased in 1989 to £200,000 (€254,000). Section 35 thus began as a corporate rather than individual investor scheme.
- 2.5 In 1993 the Minister for Arts, Culture and the Gaeltacht made a significant change to Section 35 which is reflected in Section 481 today, namely the opening up of the scheme to individual investors. The Minister also amended the Broadcasting Act to require RTE to spend a minimum amount of the annual license fee on independently commissioned programmes and recommenced the funding of the Irish Film Board which had been suspended in 1987 when the Section 35 tax incentive was introduced.
- 2.6 The 1993 amendments raised the upper limit for corporate investors to £350,000 (€444,500), and allowed for individual investors to invest up to £25,000 (€31,750).
- 2.7 Section 481 of the Taxes Consolidation Act 1997 replaced Section 35 and incorporated changes made to Section 35 in Finance Acts 1996 and 1997.
- 2.8 Further amendments to qualifying costs were introduced in Finance Acts 2000 and 2003, and Finance Act 2004 assigned the certification role for qualifying productions to the Revenue Commissioners. The amount of total cost which could be raised by section 481 was raised to €15m from the previous limit of €10.48 (£8.25m) that had applied since 1997.
- 2.9 It should be noted that the reduction in corporation tax rates in 2003 led to a reduction in the strength of the incentive for corporate investors who would only shield 10% (80% of 12.5%) of their investment from tax. Whilst the incentive would remain open to corporate investors the reduction in corporation tax rates led to the unintended consequence of the scheme becoming a primarily individual investor led scheme.
- 2.10 Finance Act 2006 increased the absolute amount of Section 481 funding that could be raised from €15m to €35m and also raised the percentage amount of total costs which could be funded by Section 481 to 80%.

2.11 The most recent changes in the incentive were introduced in 2008 following a review by the Department of Finance. These changes raised the ceiling on qualifying expenditure from €35m to €50m.³ The ceiling for individual investor investments was raised from €31,750 to €50,000 and investors were allowed to claim relief at their marginal rate on 100% of their investment as against the previous limit of 80%. This effectively doubled the maximum tax relief from a previous maximum benefit of €10,414 (80% of €31,750) to €20,500. A full description of how Section 481 operates today is contained in Annex 1.

Production Activities Covered

2.12 The production activities covered by Section 481 are:

- TV drama (incoming and local);
- Animation (incoming and local);
- Feature film (incoming and local); and,
- Documentary.

TV drama

2.13 A number of international commissioning bodies and TV networks have in recent years located some of their major productions in Ireland (e.g. *'the Tudors'* and *'Camelot'*). Similarly Irish producers have produced their own international television drama projects for the international market (e.g. *'Vikings'*).

2.14 According to the Irish Film Board 2010 was a particularly strong year coming on the back of changes to Section 481 introduced during 2009. 2011 saw a fall off from the 2010 high. The Irish Film Board expect a return to growth in 2012 driven by the production of the BBC television series *'Ripper Street'*, *'Vexed'*, *'Foyles War'* and of the indigenously developed *'Vikings'* series for the History Channel.

2.15 Support from Irish broadcasters has resulted in a growth in indigenous television drama production during 2008 and 2009. Some of these had strong domestic success (e.g. *'Love/Hate'* and *'Raw'*). The Irish Film Board submission noted that overall indigenous TV drama production has decreased significantly since 2009 on the back of reduced expenditure by RTÉ which has fallen from €43m in 2008, to €33m in 2009, €29m in 2010 and €25m in 2011.

Feature Film Production

2.16 In its submission the Irish Film Board note that the indigenous feature film segment continues to be challenged as a result of difficulties in securing international financing which is an essential part of the funding of medium budget feature films. However, a small number of indigenous feature films have achieved notable successes (e.g. *'Once'* with Glen Hansard, *'Garage'*

³ Qualifying expenditure refers to the total spend by the production on Irish goods, services and facilities including the cost of EU cast and crew working in the State.

with Pat Shortt and *'The Guard'* with Brendan Gleeson). *'The Guard'* was the most commercially successful Irish independent feature film of all time and one of the biggest domestic hits of 2011. This was one of the first productions distributed by an Irish company. The newly established Irish distribution company, Element Pictures Distribution, secured the Irish and UK distribution rights. This highlights the potential value of increased vertical integration in the sector.

- 2.17 Most recently, the indigenous feature films *'Byzantium'* directed by Neil Jordan with Saoirse Ronan, *'What Richard Did'* directed by Lenny Abrahamson and *'Jump'* directed by Kieron J. Walsh, have been selected for screening at the Toronto Film Festival in September 2012.
- 2.18 Ireland has struggled to compete in the incoming feature film space partly as a result of cost differentials with Eastern European locations and differences in qualifying expenditure with the UK. Key players in the industry have instead shifted much of their focus towards the incoming television drama area.
- 2.19 The incoming feature film segment is now focused on co-productions with other European countries. These productions have not matched the scale of the previous incoming Hollywood feature films. There have been some recent incoming productions including *'Haywire'* (directed by Steven Soderbergh) and *'Albert Nobbs'* (starring Glenn Close).

Animation

- 2.20 The animation segment has performed strongly in recent years. The past 5 years has seen growth in both indigenous and incoming productions reflecting Ireland's growing international reputation for animation production. This is reflected in Oscar nominations for the *'The Secret of Kells'* and BSE/IFB funded short films including *'Granny O'Grimm'*, *'Give up Yer Old Sins'* and *'50% Grey'*.
- 2.21 Irish companies have been successful in interacting with third level colleges, winning contracts from international studios and broadcasters including Disney and Cartoon Network, and becoming part of the digital world moving into computer games and apps. Major TV series have in the recent past been commissioned by Disney from Brown Bag and Boulder Media, including *'Doc McStuffins'*, *'The Happy Huggle Monsters'* and *'Gumball'*.

Documentary

- 2.22 The recent rise in the number of documentaries has been enabled by a significant level of the Broadcasting Authority of Ireland Sound and Vision Fund going to documentaries. In Round II (one of two rounds in 2011) €3,886,000 was allocated by the BAI to documentaries (45% of the total BAI allocation in that round). This is a segment of relatively low cost individual productions producing some high profile work (e.g. *'His and Hers'*, *'Knuckle'* and *'The Pipe'*).

Other State Supports to the Audiovisual Sector

- 2.23 State supports to the audiovisual sector also include direct grant aid by the Irish Film Board (IFB) and the Broadcasting Authority of Ireland (BAI), as

well as indirect support through the commissioning and procurement of domestically produced audiovisual productions by the State owned broadcasters RTE and TG4.

IFB Funding

2.24 The Department of Arts, Heritage and the Gaeltacht allocated €13.1m in grant-in-aid to the IFB for capital funding purposes in 2012. This represents a reduction of 34% from its 2008 level of €20m. Some of this funding will go to training but the majority finances the funding the development, production and distribution of projects. IFB funding is a separate funding source to equity investments by investors under the Section 481 scheme. A detailed description of IFB funding is set out in Annex 1 to this report.

BAI funding

2.25 A proportion of the television license fee is allocated to the BAI for the support of indigenous productions through the Sound and Vision Scheme II. This scheme is designed to provide funding for television or sound broadcasting programmes including feature films, animation and drama on statutory outlined themes of: Irish culture, heritage and experience; Adult Literacy or Media Literacy; and, Ireland's context in Global affairs.

2.26 The ratio of television to radio funding currently stands at 80%/20%. This is as a result of the high cost differential between television and radio production. The BAI allocates grants under Sound & Vision II that represent up to 95% of the production costs for the programme. In 2011 approximately €7.8m was allocated to television production. A detailed description of BAI funding is set out in Annex 2 to this report.

Previous reviews of Section 481

The Indecon Review

2.27 Section 481 was most recently reviewed in 2007 by Indecon economic consultants on behalf of the Department of Finance. The Indecon analysis indicated that while total tax and other benefits exceeded the costs of the scheme, when account was taken of even relatively low levels of opportunity costs, the benefits of the scheme to the Irish economy were found to be low and declining.

2.28 Indecon noted at the time that for every €100 raised under Section 481, the exchequer cost was €34 but that only €19 accrued as a subsidy to the producers with the balance being returned to investors or accounted for in administration costs. Investors received back on average 76% of their investment and thus their return was entirely due to the tax benefit of their investment (at the investor's marginal rate).

2.29 Given the changes in the labour market in Ireland post-2008 and the changes made to the scheme in recent Finance Acts it seems timely to re-examine the costs and benefits to the economy of the S481 relief.

2.30 Indecon also made a number of specific proposals to support the future development of the Irish audiovisual sector:

1. The S481 scheme should remain for the next 3-5 year period but should be subject to review in advance of the expiry date;
2. No change should be made to incentives for television production;
3. Enhancements should be made to the incentives for film production;
4. An enhanced grant scheme should be provided by the Irish Film Board as an optional incentive conditional on such projects not also obtaining S481 relief
5. The Irish Film Board should prepare a 10 year strategic plan to address the sustainability of the industry and its vulnerability to tax incentives in other countries and to enhance its net economic contribution.

Box 2: Indecon recommendations

Source: Review of Section 481 Film Relief, Indecon International Consultants, 2007

The Commission on Taxation

- 2.31 The Commission on Taxation (2009) recommended that film relief should be continued but should be subject to regular review in accordance with the principles set out in their report.⁴
- 2.32 The Commission noted that the structure of the relief and manner in which it may be used raised a question of equity with those lower down the income scale less likely to have the initial capital to leverage a loan in order to avail of the relief.
- 2.33 The Commission recognised the competitive international environment which exists in the film industry and also the role which the sector plays in supporting a significant number of jobs in the economy.
- 2.34 It concluded that the relief should be continued but subject to regular review in accordance with the following principles:

Where a tax expenditure is proposed or an existing expenditure extended, the following questions should be asked:

1. Does the tax expenditure correct a market failure, attract mobile investment, or offset shortcomings in other areas of public policy?
2. If so, does the proposal adhere to the principles of efficiency, stability and simplicity; and,
3. If so, can the departure from the equity principle, which the tax expenditure invariably necessitates, be justified?

A tax expenditure should only be introduced or extended if it answers affirmatively to each of these questions

Box 3: Commission on Taxation principles for introducing or extending tax expenditures

Source: Commission on Taxation Report 2009

⁴ The Commission on Taxation report is also available on the Department of Finance's tax policy website: <http://www.commissionontaxation.ie/Report.asp>

Creative Capital Report

- 2.35 Following the Indecon report, the Irish Film Board (IFB) initiated a major independent review of the industry. The first stage involved commissioning PWC to develop an up-to-date, complete and accurate view of the size and character of the audio visual content production sector.
- 2.36 Following the presentation survey report by PWC to the Department of Arts, Heritage and the Gaeltacht, an audiovisual strategic review steering group was established to examine and recommend new enterprise policies to maintain and develop the industry's growth. Its report, titled 'Creative Capital' identifies the Irish audiovisual sector as a pillar of Ireland's creative industries and a major opportunity to deliver growth and jobs to the Irish economy over the next five years.⁵
- 2.37 It identified the potential to double the size of the sector over the next 5 years both in terms of turnover (from €500 million to over €1 billion) and in terms of employment (growing from over 5,000 full-time equivalent jobs to over 10,000 full-time equivalent jobs).⁶ The report identifies 5 key priority areas which have now been adopted as national strategy. Many of the priority areas are linked with ongoing Section 481 support (directly and / or indirectly).
- 2.38 The report acknowledged that the recent extension of Section 481 will be an important cornerstone for further growth. However it added that long term growth of inward investment for international production is likely to require a longer term horizon and thus recommended the extension of Section 481 relief to 2020.
- 2.39 It also made two further recommendations that relate to other tax expenditures, namely the extension of the R&D tax credit to include content development and, the extension of the employment and investment incentive ("EII", formerly the business expansion scheme) to include audiovisual content production companies.

1. Extend S481 to 2020
2. Extend Research and Development Tax Credit to include content development
3. Extend Employment and Investment Incentive Scheme to include audiovisual content production companies.

Box 4: Creative Capital tax recommendations

Source: Creative Capital, Building Ireland's Audiovisual Economy

- 2.40 The Creative Capital Report was launched by the Minister for Arts, Heritage and the Gaeltacht, Jimmy Deenihan TD in July 2011 and submitted to cabinet. The cabinet requested an Inter-departmental Steering Committee

⁵ The Report is available at the following address:
<http://193.178.1.186/pdfs/creative%20capital%20final%202011.pdf>

⁶ The creative capital estimate for full time equivalent employment relates to the entire audiovisual sector and is therefore broader than employment from Section 481 supported activities which was estimated by Indecon on behalf of the IBEC Audiovisual Federation to be 1606 in 2011.

be appointed to assess, and where practical, to oversee the implementation of these recommendations. These actions have also been included in the Governments Actions Plan for Jobs 2012 launched in February this year.

3. Analysis of Data

- 3.1 This Chapter presents an analysis of claims and tax receipts data provided by the Revenue Commissioners and the Irish Film Board relating to Section 481.
- 3.2 Both Revenue and the IFB provided detailed data on Section 481 expenditure from 2005-2011. This data provided a detailed breakdown across all productions of:
- Total budget;
 - Eligible spend for Section 481 purposes;
 - Section 481 funds raised; and,
 - The labour and materials and services components of the eligible spend.
- 3.3 In addition a team from the Department's economics division were authorised by Revenue to access its case files, including tax receipts from Section 481 productions, on a confidential basis. The Department's officials have built the data into an aggregated anonymised data set which can be used to quantify the tax benefits from Section 481 productions. Estimates of direct employment from Section 481 productions were also derived from the Revenue files.

Expenditure Data

- 3.4 The Revenue and IFB data (Revenue/IFB data) lists the total budget, section 481 funds, labour and materials and services for all productions over the period 2005-2011. The data also lists all productions by their production type – e.g. animation, documentary, feature film and TV drama.

Numbers of production

- 3.5 The Figure below illustrates the volume of Section 481 production activity over the period 2005-2011. As can be seen the total volume of productions has increased markedly since 2005, with a greater than twofold increase occurring over the period with 57 productions in 2011 compared with 26 in 2005.

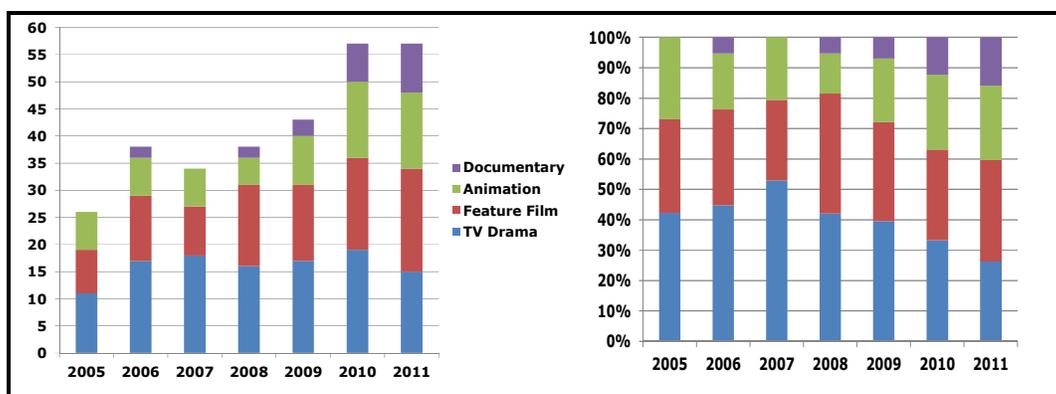


Figure 2: Number of productions by type of production 2005-2011

Source: Revenue Commissioners, Irish Film Board

3.6 Unsurprisingly feature films and TV dramas account for the majority of productions, though the overall share of these production types has fallen over time from a peak of over 80% in 2008 to 60% in 2011. The volume of animation productions has grown during this period from 5 in 2008 to 14 in 2011.

3.7 The Table below further expands the production activities into incoming productions and locally originated productions. It is clear that throughout the period 2005-2011 in each of TV drama, feature films and animation the majority of productions are locally originated. In 2010 a greater volume of feature films were incoming with a similar result in 2011 for animation productions. The situation for 2011 is represented in the Figure below.

| | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | Total |
|-----------------------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|------------|
| TV Drama Incoming | 2 | 8 | 8 | 6 | 3 | 11 | 5 | 43 |
| TV Drama Local | 9 | 9 | 10 | 10 | 14 | 8 | 10 | 70 |
| Feature Film Incoming | 3 | 4 | 3 | 5 | 5 | 9 | 6 | 35 |
| Feature Film Local | 5 | 8 | 6 | 10 | 9 | 8 | 13 | 59 |
| Animation Incoming | 6 | 3 | 5 | 3 | 6 | 8 | 8 | 39 |
| Animation Local | 1 | 4 | 2 | 2 | 3 | 6 | 6 | 24 |
| Documentary | | 2 | | 2 | 3 | 7 | 9 | 23 |
| Total | 26 | 38 | 34 | 38 | 43 | 57 | 57 | 293 |

Table 2: Numbers of productions

Source: Revenue Commissioners, Irish Film Board

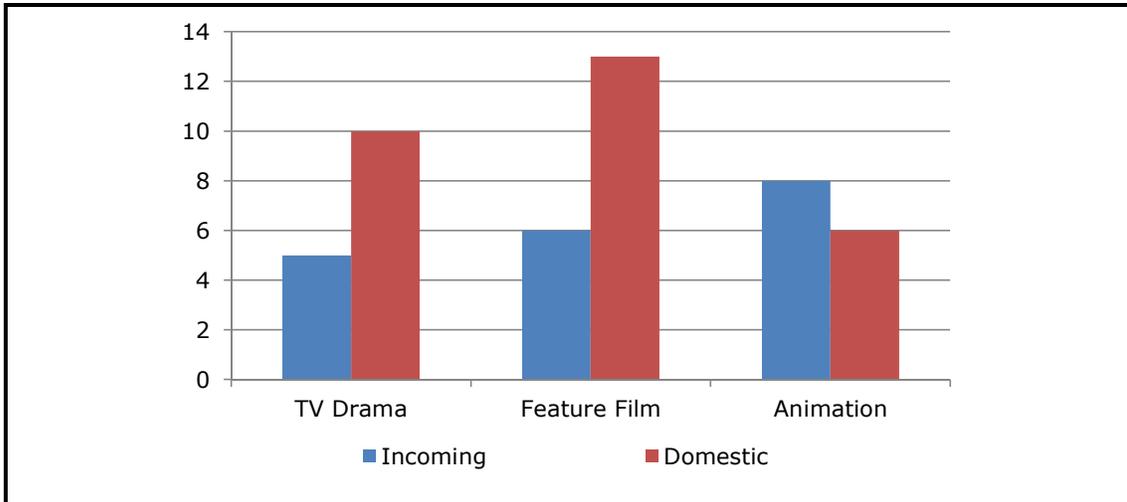


Figure 3: Number of productions by type of production 2011

Source: Revenue Commissioners, Irish Film Board

Expenditure

3.8 The amount of annual expenditure has grown substantially since 2005 with €118m spent on Section 481 productions in 2011 compared with €57m in 2005. The expenditure has consistently been in the range of €105m to €120m from 2006 with the exception of 2010 when the level of expenditure reached €164m with approximately €30m of the 2010 expenditure accounted for by Camelot, a production that did not reoccur in 2011.

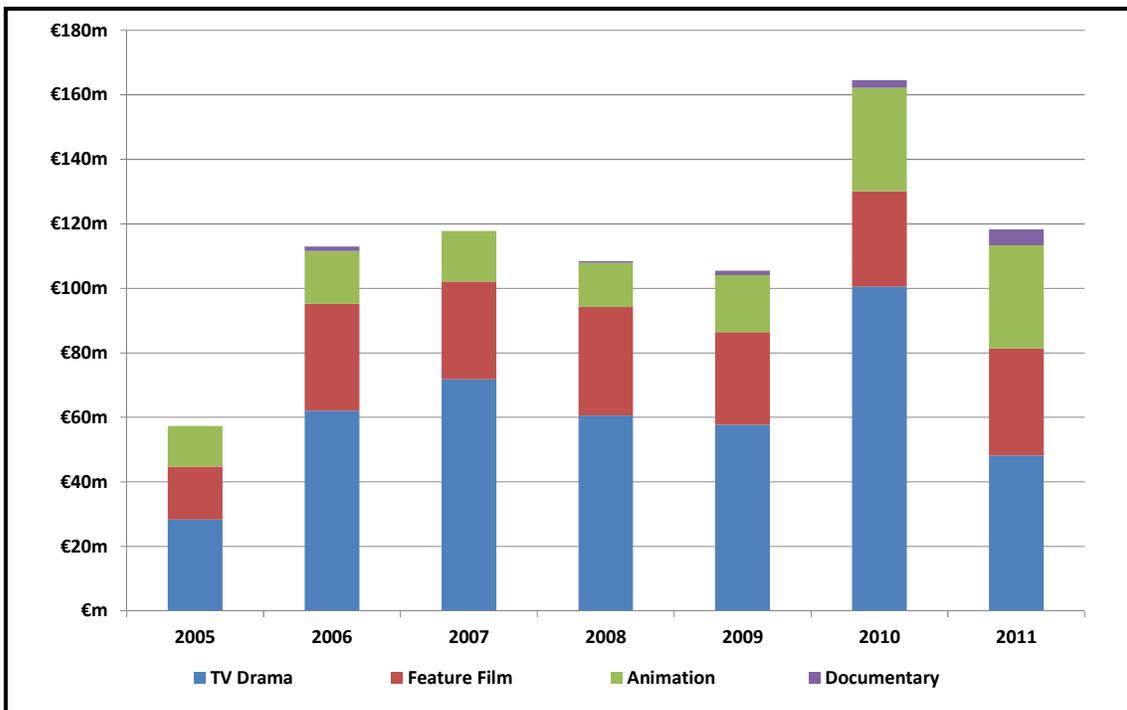


Figure 4: Expenditure, 2005-2011

Source: Revenue Commissioners, Irish Film Board

- 3.9 The largest activity in terms of the share of expenditure has been TV drama. Within TV drama, incoming productions accounted for higher expenditure, an outcome that has broadly held since 2006 (see Table 3) below. This is an interesting outcome given the higher volume of local TV productions as illustrated in Table 2 above, thus indicating a higher intensity of expenditure by incoming TV drama productions.
- 3.10 The full breakdown of expenditure both in total amount and on a per production basis across all activities including a domestic and incoming basis are set out in the table and figure below. The importance of incoming TV drama is illustrated in Figure 5 with its per production expenditure in a range of two to three times larger than any other categories over the last four years.

| | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | Total |
|-----------------------|-------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|
| TV Drama Incoming | €3m | €38m | €47m | €37m | €28m | €85m | €28m | €265m |
| TV Drama Local | €25m | €24m | €25m | €24m | €30m | €16m | €20m | €164m |
| Feature Film Incoming | €11m | €15m | €6m | €12m | €17m | €22m | €13m | €95m |
| Feature Film Local | €5m | €19m | €25m | €21m | €12m | €8m | €21m | €110m |
| Animation Incoming | €12m | €6m | €13m | €9m | €13m | €23m | €20m | €95m |
| Animation Local | €1m | €10m | €3m | €5m | €5m | €9m | €12m | €45m |
| Documentary | | €1m | | €m | €1m | €2m | €5m | €11m |
| Total | €57m | €113m | €118m | €108m | €105m | €165m | €118m | €785m |

Table 3: Expenditure of Section 481 productions, by production type, 2005-2011

Source: Revenue Commissioners, Irish Film Board

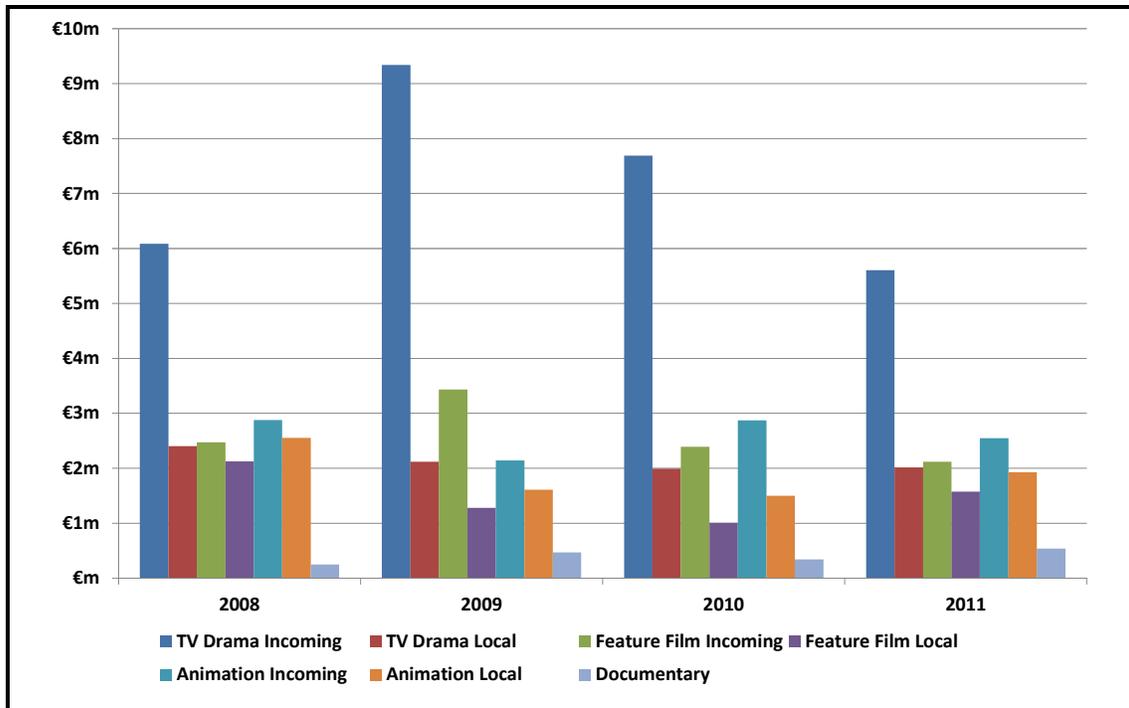


Figure 5: Per production expenditure 2008- 2011

Source: Revenue Commissioners, Irish Film Board

- 3.11 It is worth summarising the relative split between incoming and local productions on an aggregate basis, both in terms of the number of productions and also in total qualifying expenditure. This is relevant as international and local production may respond differently to changes in the tax regime, a point that is returned to in Chapter 9 which sets out the Department's cost benefit model.
- 3.12 As set out in the table and chart below, the largest share of productions in volume terms are locally commissioned, whereas with the exception of 2005 the largest quantity of expenditure came from the incoming productions, i.e. those that were commissioned outside of Ireland, in other words incoming expenditure have higher per-production expenditure than domestic productions. This point confirms the evidence presented in Figure 4 above.

| | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | Total |
|-------------------------------|------|------|------|------|------|-------|------|-------|
| Numbers of Productions | | | | | | | | |
| Incoming | 11 | 15 | 16 | 14 | 14 | 28 | 19 | 117 |
| Domestic | 15 | 23 | 18 | 24 | 29 | 29 | 38 | 176 |
| Total Expenditure | | | | | | | | |
| Incoming | €26m | €58m | €66m | €58m | €58m | €129m | €61m | €456m |
| Domestic | €31m | €55m | €52m | €51m | €47m | €35m | €57m | €329m |

Table 4: Volume and value of incoming and domestic productions, 2005-2011

Source: Revenue Commissioners, Irish Film Board

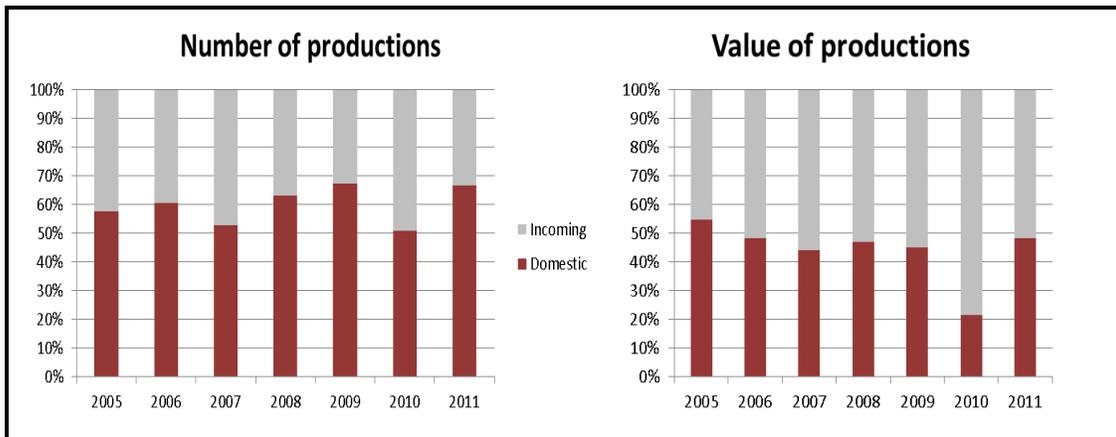


Figure 6: Volume and value of productions, percentage share, 2005-2011

Source: Revenue Commissioners, Irish Film Board

3.13 The Revenue/IFB data also facilitates a split of the total expenditure into labour and materials and services. The Figure below presents the share of labour and materials and services over the period 2008-2011 on a per production basis. For all production categories except documentaries 'labour' occupies a higher share of the eligible expenditure for Section 481 purposes. The highest labour intensity is for local animation where labour occupies a 60% share. Though not included in the graph, the intensity of labour expenditure for local animation increases to 72% in 2011 with all other categories remaining broadly similar to the breakdown presented.

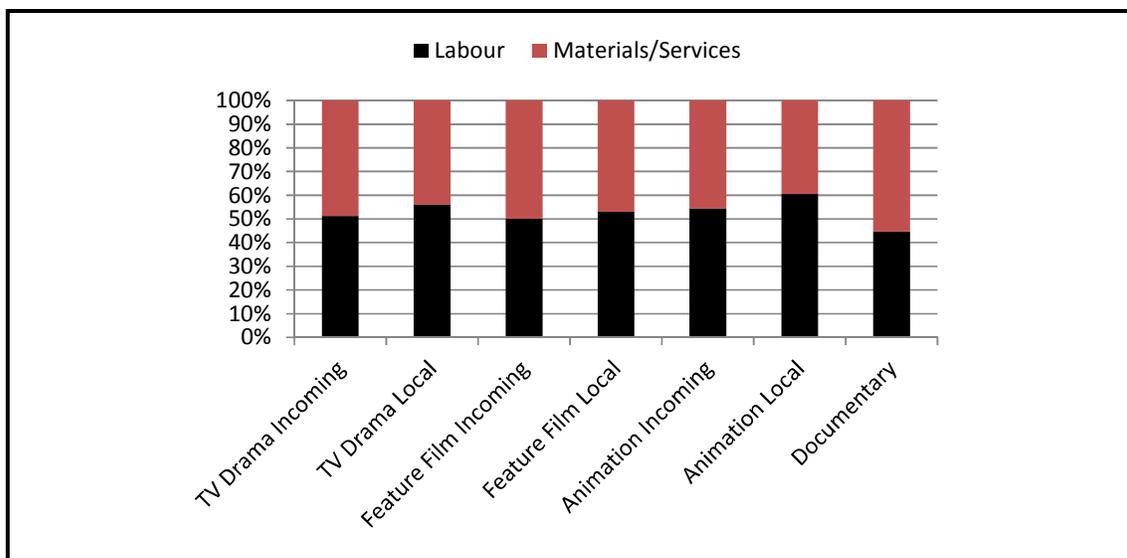


Figure 7: Labour and materials/services share of per production expenditure, 2008- 2011

Source: Revenue Commissioners, Irish Film Board

Taxation data

Exchequer Cost

3.14 The IFB/Revenue data facilitates a calculation of the annual exchequer cost of the Section 481 incentive. In making the calculation it should be noted that the incentive was enhanced in 2009 to allow for investors to offset 100% of the value of their investment against income tax in 2009, as against 80% in previous years. Also the top marginal tax rate was reduced from 42% to 41% in tax year 2007.

| | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 |
|------------------------------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|
| Section 481 Amount | €48.3m | €107.8m | €94.8m | €102.9m | €100.0m | €160.2m | €113.4m |
| Allowable investor relief | 80% | 80% | 80% | 80% | 100% | 100% | 100% |
| Higher rate of personal income tax | 42% | 42% | 41% | 41% | 41% | 41% | 41% |
| Estimated tax cost | €16.2m | €36.2m | €31.1m | €33.7m | €41.0m | €65.7m | €46.5m |

Table 5: Tax cost derived from expenditure of Section 481 productions, 2005-2011

Source: Department of Finance analysis based on Revenue/IFB data

3.15 Based on €113.4m in Section 481 funds raised in 2011 the exchequer cost is estimated at €46.5m. Whilst this is substantially lower than the estimate for 2010 it is the second highest in the sample period. In any event the 2010 outturn is a result of a windfall from a one-off production of Camelot which was not repeated in 2011. The impact of the enhancement to the incentive

is also clearly evident in the step change that arose in 2009 vis-à-vis earlier years.

Exchequer Receipts

- 3.16 The Revenue Commissioners provided authorisation to a team from the Department's Economics Division to access Revenue's case files on a confidential basis for the purposes of building a data set on tax receipts.
- 3.17 The Revenue files provide a full record of PAYE receipts, USC receipts, PRSI contributions across all employees as well as net VAT payments by the production. Section 481 companies do not make profits and thus corporation tax receipts are zero.
- 3.18 In terms of schedule D (self-employed) income tax receipts, the Revenue returns for these cases do not permit an identification of individuals engaged in Section 481 productions. The Department has therefore made an estimate based on published historical data by the IBEC Audiovisual Federation. The methodology is described below.
- 3.19 The Revenue files also list the number of employees engaged in each production though many of these are not full time equivalent (FTE) employees. An estimate of FTE employees was made based on an analysis of a sample of productions. For consistency this estimate is compared with an estimate produced by Indecon Economic Consultants on behalf of the IBEC Audiovisual Federation.
- 3.20 The estimated tax receipts are set out in the Table below. For all categories except Schedule D, the actual receipts from Revenue files are reported. For schedule D, an estimate is made based on published data the IBEC Audiovisual Federation annual reviews. For 2007-2010 IBEC's published figure for Schedule D receipts is used. As IBEC's annual review has not yet been published for 2011 an estimate for total Schedule D labour salaries is derived based on total labour expenditure for 2011 times the ratio of the IBEC Schedule D report expenditure to total labour expenditure for the period 2007-2010. An effective tax rate of 34% which is consistent with the Indecon report on behalf of the IBEC Audiovisual Federation is applied to this estimate.

| | 2007 | 2008 | 2009 | 2010 | 2011 |
|-----------------------|---------------|---------------|---------------|---------------|---------------|
| PAYE | €2.0m | €2.2m | €2.3m | €2.9m | €1.6m |
| PRSI | €1.9m | €2.1m | €2.3m | €3.5m | €1.7m |
| Schedule D | €17.9m | €17.9m | €15.1m | €30.9m | €17.8m |
| USC/Income Levy | | | €0.3m | €0.4m | €0.7m |
| VAT | €2.2m | €2.1m | €2.0m | €3.4m | €5.4m |
| Total Receipts | €24.0m | €24.3m | €21.9m | €41.1m | €27.2m |

Table 6: Tax receipts by heading, 2007-2011

Source: Department of Finance analysis based on Revenue case data and IBEC Audiovisual Federation annual review

3.21 The data reported in the Table above along with the estimated tax cost are used as inputs into the Department's costs-benefit model. This process is described in chapter 8.

Employment Data

3.22 The Revenue files provide data on the number of individuals that worked on productions in a given year. However the data doesn't distinguish whether an individual spent a full person-year working on a production or if the individual spent only a week or a day on the production. Similarly an individual may have worked on a number of productions and would be counted for each production in the aggregation of total employment. It is therefore not possible to estimate the number of full time equivalent employees from the Revenue files.

3.23 The IBEC Audiovisual Federation publishes an annual statistical review of film and television production in Ireland. The review relies on a survey of members and presents various expenditure and employment data. One of the statistics produced annually in the review is an estimate of the full time equivalent (FTE) employment on Section 481 productions.

3.24 The IBEC FTE estimate uses the total hours worked on Section 481 productions as well as the number of employees to derive an estimate for FTE employment. IBEC's estimates are presented below. An estimate for the exchequer cost per FTE is also provided. The FTE numbers for 2006 to 2010 are from the Audiovisual Federation statistical reviews. The number for 2011 comes from the Indecon submission on behalf of the Audiovisual Federation.

| Year | Total Employed | Full Time Equivalent Jobs | Exchequer cost per FTE |
|------|----------------|---------------------------|------------------------|
| 2006 | 17,476 | 1,814 | €19,964 |
| 2007 | 14,711 | 1,735 | €17,930 |
| 2008 | 15,147 | 1,631 | €20,693 |
| 2009 | 17,013 | 1,368 | €29,956 |
| 2010 | 26,537 | 1,695 | €38,762 |
| 2011 | | 1,606 | €28,956 |

Table 7: Employment and full time equivalent estimates

Source: IBEC Audiovisual Federation Annual Reviews, Indecon (2012) submission

Note: Based on a 38 hour week and a working year of 232 days. The 38 hour average is taken from a 39 hour week average for manual workers and a 37 hour week for clerical, professional and technical workers. The 232 day working year is derived as follows: 365 minus 104 days weekends minus 9 public holidays minus 20 days average annual leave days = 232

Note: Cost per FTE based on estimated exchequer cost in Table 5 above

Profile of Investors

3.25 A further area of interest is the profile of investors that benefited from Section 481 relief. Revenue provided data for 2009 and 2010 on the numbers of investors, their income levels and their claim size across a range of income levels. The data for 2010 is summarised in the Table below. In discussing the economics of Section 481 in chapter 5, the profile of investors in Section 481 relief is compared to the profile for another investor based relief, the Business Expansion Scheme.

- 3.26 As can be seen, 74% of all beneficiaries of Section 481 relief in 2010 were individuals with income in excess of €100,000. These individuals accounted for 82% of the investments in terms of the total amount invested.

| Income level | Share of number of claims | Share of amount of investment |
|-----------------------|---------------------------|-------------------------------|
| Less than €100,000 | 26% | 18% |
| €100,000 - €150,000 | 28% | 27% |
| €150,000 - €200,000 | 17% | 19% |
| €200,000 - €275,000 | 12% | 15% |
| Greater than €275,000 | 17% | 22% |

Table 8: Percentage share of claims and maximum cost by income band in 2010

Source: Department of Finance analysis of Revenue data

4. Outcome of the Public Consultation Process

- 4.1 The Department of Finance undertook a public consultation process as part of the economic impact assessment. On 28 of May 2012 the Minister for Finance published a consultation paper which set out some preliminary analysis and also invited interested parties to make submissions. The closing date for receipt of submissions was 31 July, extended to 31 August.
- 4.2 In all there were 20 responses to the public consultation process. The majority of the responses (17) were from organisations/groups/bodies prominent in the industry with three submissions from individuals acting in a personal capacity. Importantly many of the submissions were received from bodies which represent a large proportion of smaller and individual interests in the film industry, for example the Screen Directors Guild Ireland. The responses varied from brief letters to detailed cost-benefit analyses.
- 4.3 The consultations provided a variety of detailed responses to the questions highlighting significant issues in relation to the film relief. The prominent theme of the consultation was the very positive opinion held by the respondents of the relief's benefits to Ireland and the industry. Key issues were raised as to the allowable expenditure of the relief in relation to non-EU labour, the flexibility of the scheme around when funding can be raised for production among other issues. There was also a strong agreement that the relief should be extended in the long-term.

Response to Consultation Questions

- 4.4 In order to assist audiovisual producers when formulating their responses, the consultation paper posed six questions for them to consider. A summary of the responses to each question follows.

Question 1: Are the exchequer's supports to the film and TV sector in Ireland through section 481 relief an efficient use of scarce resources and if so why?

All respondents affirmed that the film tax relief was an efficient use of scarce resources generally discussing the following points:

- The range of benefits to the country in terms of employment, attraction of mobile international investment, promotion/expression of culture, tourism spend, increased expenditure in the economy all as a result of the scheme;
- The operation of the scheme is considered to be simple, transparent and effective
- The scheme's availability of access to indigenous, Irish talent as well as large international producers is seen as a valuable quality;
- The relief was viewed very favourably with respect to other methods of support in operation in other countries such as tax credits and grant systems.
- Many cited the findings of Indecon's reports in 2007 and 2012 which found a net benefit to the scheme;⁷
- A number of parties argued that the level of deadweight and displacement associated with the scheme is low implying that the relief is an efficient intervention

⁷ The findings of Indecon's 2012 report are considered in chapter 8 of this report

Question 1: Are the exchequer's supports to the film and TV sector in Ireland through section 481 relief an efficient use of scarce resources and if so why?

- in the economy⁸
- Many consider that the proportion of the tax foregone that goes directly to the film producer was high (28% out of the 41% marginal tax relief);
 - The scheme is believed to be attracting greater funding than would be achieved from banks alone due to the inherent risk involved in audiovisual production; and,
 - Other points discussed include the possible value an expert steering group may have in overseeing the relief going forward, the low risk borne by the investors being as a result of the quality of due diligence and the increased importance of S481 as a source of industry funding in the past few years.

Box 5: Summary of responses to consultation paper question number 1

Source: Department of Finance analysis of Responses to Public Consultation

Question 2: Is the current scheme maximising the potential economic benefits to Ireland in terms of stimulating activity in the film and TV sector, if not why not?

Many responses in this section go into detail on the key benefits of the scheme while others highlight areas where the current operation of S481 unnecessarily limits activity that could be taking place under the scheme. Common issues raised were:

- The early receipt of funds in the production process is seen as key especially when compared to other methods of film support such as tax credits, where in many cases the credit can only be claimed at the end of production or borrowed against at a discount on the face value of the tax credit;
- In the case of grant based support the respondents highlighted that threshold expenditure limits have to be met and confirmed by external auditor before release of funds which normally occurs late in the production process;
- The availability of funds to both experienced and inexperienced producers is seen as a benefit as well as the transfer of human capital to Irish labour as a result of large international productions choosing to locate here;
- One respondent highlighted that a multiplier of 2.34 should be used in measuring the benefits of the S481 spend in the economy which is higher than previous multipliers used in evaluations of the scheme;⁹
- There was a concern raised about the technical requirement that the amount raised under the S481 be made available to the production company before 25% of the total production budget has been incurred. It is felt this negatively impacts Irish productions that don't control the total production spend such as post-production companies. This is deemed not practicable given that some companies only conclude contracts with commissioning companies after the overall production has already begun. This rule also implies that for example, orders for extra episodes in relation

⁸ The Department's view on deadweight effects is contained in chapter 8 of this report

⁹ The Department's views on multipliers is set out in Chapter 8 of this report

Question 2: Is the current scheme maximising the potential economic benefits to Ireland in terms of stimulating activity in the film and TV sector, if not why not?

- to TV series cannot be funded using S481 once initial funding has been raised;
- It is felt that S481's structure is limited in its ability to respond to developments in other jurisdictions and new business models such as online distribution ;
- The requirement that S481 application be made 21 days before production begins is felt to limit opportunities for business in the industry. This requirement involves criteria connected to activities that may have no connection to Ireland and their removal or modification are identified as potential ways to increase activity in Ireland; and,
- Remuneration of investors in S481 is dependent on submission of a compliance report, part of which can be dependent on actions of non-Irish producers. It is felt this unnecessarily delays payment of the investors and reduces the attractiveness of the relief.

Box 6: Summary of responses to consultation paper question number 2

Source: Department of Finance analysis of Responses to Public Consultation

Question 3: What are the economic arguments for restricting or terminating the scheme?

None of the respondents supplied arguments for restricting the relief. Many went on to discuss the negative effects of a restriction or elimination of the relief.

- Many discuss the negative effects it could have on the industry in light of the increasing competition in the support of film internationally with specific attention placed on the forthcoming changes to the UK's system of supports;
- A few specifically argue that the level of deadweight associated with the scheme is low which implies that without the relief very few productions would take place in Ireland;
- The elimination of S481 would also eliminate the possible benefits of extending the relief to the video games industry according to some respondents; and,
- They also highlight the highly specialised labour skills in the industry and raised the possibility that this labour wouldn't find employment to match their skills in the economy should the industry shrink in the case of an elimination of the relief.

Box 7: Summary of responses to consultation paper question number 3

Source: Department of Finance analysis of Responses to Public Consultation

Question 4: What possible changes to the existing scheme, if any, should be considered and why?

There were a variety of changes which were proposed for both the structure of and the remit of the scheme. A summary of the main points is included below:

- There was a recommendation that changes to the system be marginal due to the difficulty the industry would face in responding to a significant change in the relief
- A requirement was proposed that key staffing roles, specifically directors, be filled by Irish talent for the production of the film/TV series as a condition of aid;
- There were recommendations not to move to a tax credit support system with the reason cited as; the inability of credits to supply the necessary cash flow to fund a film and the lack of financial intermediaries who would be willing to lend against the value of the credit;
- A proposal for the extension of the scheme to the gaming sector and digital production is advocated by many. The reasons given were the cognate skills between special FX in the film industry and computer generated images in gaming which creates the possibility to develop a critical mass of technical skills in the industry and Ireland. Similarly to cognate skills, it was also identified that specific jobs are common to both industries such as voice acting and story direction and as such allow for a greater demand for labour;
- An extension of allowable expenditure for the S481 budget to include non-EU labour is mentioned often. This is perceived to have a strong influence on international productions choosing to locate here due to key talent in film productions such as leading actors or directors often being non-EU citizens;
- An extension of the scheme out to 2020 as recommended in the Creative Capital report is considered likely to help maximise the benefits of the scheme by introducing certainty and allowing for the planning associated with large and/or international productions; and,
- Another issue raised by the consultation is the desire for an increase in the percentage of the relief that went to production activities rather than unnecessary items like office space and public relations for individuals in the production.

Box 8: Summary of responses to consultation paper question number 4

Source: Department of Finance analysis of Responses to Public Consultation

Question 5: Do interested parties agree there is merit in extending the S481 Film Relief Tax incentive scheme beyond 2015? If yes, why? If no, why not?

No submission suggests the scheme should end in 2015. Most discuss the benefits of extending the relief into the long-term with some citing the recommendations of the Creative Capital report to extend it out to 2020.

Box 9: Summary of responses to consultation paper question number 5

Source: Department of Finance analysis of Responses to Public Consultation

Question 6: How does the scheme interact with other enterprise tax incentives such as the BES/EII?

In general many responses felt there is no relationship between the two schemes. Others highlight that BES/EII and R&D tax credits could be extended to the scheme to increase attractiveness.

Box 10: Summary of responses to consultation paper question number 6

Source: Department of Finance analysis of Responses to Public Consultation

5. Outcome of survey of audiovisual producers

- 5.1 This chapter describes the outcome of a survey and interviews with, domestic and international producers. This was carried out on behalf of the Department of Finance by BDO and Amárach after a competitive tender process.¹⁰ The overall purpose of the survey was to:
- Ascertain quantitatively the impact of Section 481 Relief in financial terms; and,
 - Get qualitative feedback on possible alternative solutions to the scheme which is currently in place.
- 5.2 This chapter is divided into three areas:
- Overview of Audiovisual Companies that participated and their activities in Ireland;
 - Geography of Section 481 productions; and,
 - Industry's Views on Section 481 Relief and other funding options.
- 5.3 Amárach were provided with a list of 63 production companies by the Department of Finance who were in receipt of S481 funding in the past. Ultimately, 51 of these companies were contacted as part of the survey. The reduced number is a result of 12 companies having ceased trading since their receipt of a S481 certificate.
- 5.4 In addition, BDO conducted in depth interviews with ten production companies composed of eight domestic producers involved in TV, Film & Animation and two large international producers.
- 5.5 Overall a 48% response rate in relation to number of productions was achieved. This rises to 66% when account is taken of the firms who took part in the qualitative survey. This is positive response rate given the size of companies involved and the level of detail required. Five of the top six producers (with 10 productions or more) took part in this research, with four of them completing the quantitative survey and three completing a qualitative interview. Two of the firms participated in both elements of the research programme.

Overview of Irish Audiovisual Companies and their activities in Ireland

- 5.6 Companies were asked about their primary audiovisual activity and whether they were part of a group or operated as a standalone enterprise. They were also asked how long they were in operation and the number of full and part time employees in their companies. The results from the survey allow us to generate a representative picture of participants in the Irish audiovisual industry.
- 5.7 The results tell us that companies in the AV sector tend to be independent standalone enterprises (94%) that have been in operation for an average of 15 years. The focus of the industry is television with half of companies identifying it as their primary activity; animation, post-production and film

¹⁰ The BDO/ Amárach report is published alongside this report as a supporting annex.

account for the rest. Employment in AV companies averages at about 22 employees, 15 of whom are full-time.

Overview of AV Productions in Ireland

5.8 Respondents were asked to provide descriptive information on all their productions in the last five years on the following topics:

- Number of pitches for productions and success rate,
- Number of productions and when they occurred,
- The most common production activity of those productions (Pre, post, or principal production) and the content type (Drama, Feature Film, or Animation).

5.9 Within Ireland AV companies tend to compete more for domestic productions than international. From the period 2006-12 they averaged 5 pitches for domestic productions and 4 for international productions. On average they won 2 contracts per year whether domestic or international.

5.10 In recent years companies have seen an increasing number of productions produced every year. Since 2006 companies have on average produced 14 movies however 60% of these have occurred in the last two years. This is consistent with the increase in the supply of S481 funding observed in the data over recent years.

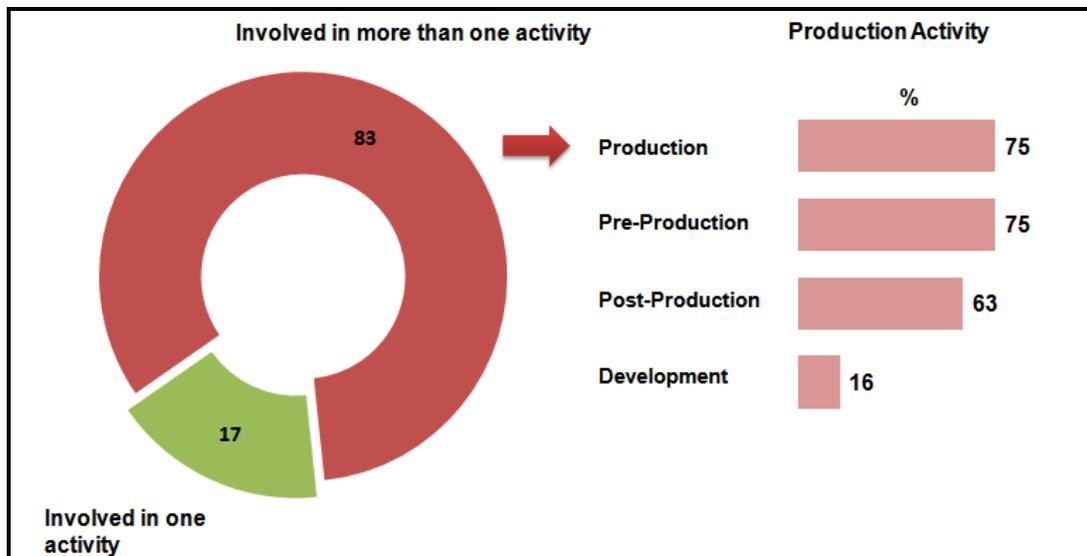


Figure 8: Breakdown of those involved in more than one activity

Source: Survey of Audiovisual Producers

5.11 At 83%, most audiovisual companies are involved in more than one type of production activity. Less than one in five (17%) are engaged solely in one production activity with post-production the largest within this group at 10% of respondents.

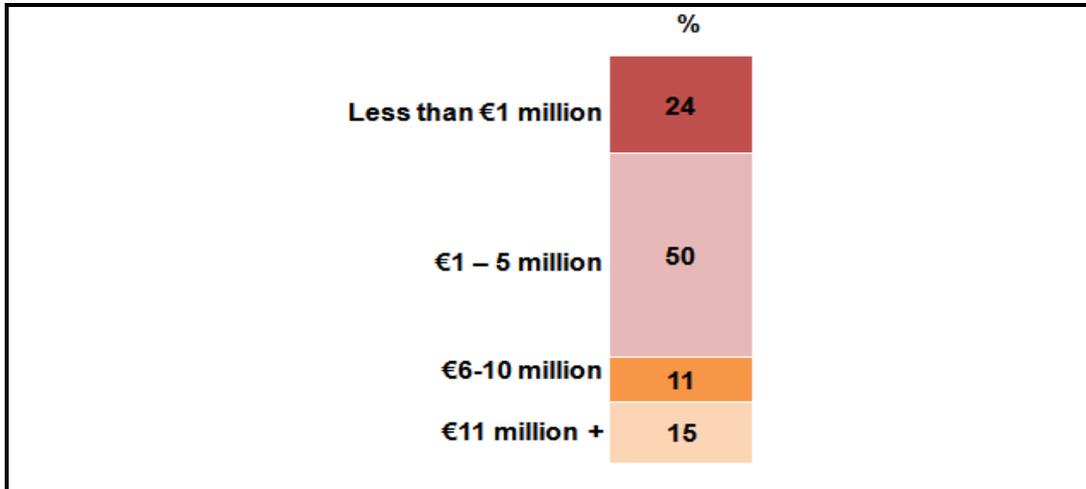


Figure 9: Frequency distribution for the average total production expenditure for their last 5 productions

Source: Survey of Audiovisual Producers

5.12 Companies were asked for the total production expenditure for their last 5 productions. The average total production expenditure for each company on was €4.5 million, with a small number of projects having a budget of more than €10 million. The figure above provides a distribution of responses.

Geography of Section 481 Productions

5.13 Respondents were asked to provide information on the location of productions and producers, such as;

- Location of commissioning body
- Location of co-producers
- Location of production
- Reason for decision to locate in Ireland

5.14 Results show almost half of productions are commissioned exclusively from an Irish base (46%). This rises to 74% when those productions commissioned in Ireland in conjunction with another region are included. A quarter of projects were commissioned or co-commissioned in the United Kingdom.

5.15 Just under half of productions (47%) were co-produced outside of Ireland. Of those where co-production occurred, the UK (37%) was the most popular co-production location. The other top co-production regions include Germany (16%), the US, France and Canada accounting for 12% of co-productions apiece. One in ten productions was co-produced in more than one country.

5.16 Where production occurs in Ireland, Dublin NUTS III region (50%) is the most popular location with the West the second most popular choice at 25%. The Mid-East and Mid-West regions accounted for a further 9% apiece, while the remaining 5% or less of productions were produced in the remaining NUTS III regions.

5.17 Those for whom the story/subject of the production was the primary driver for locating here represented 39% of companies i.e. the story/subject required filming in Ireland due to unique aspects of our landscape, architecture etc. Those companies who considered the availability of S481 funding to be the primary reason for settling here represented 36% of respondents. For a small number (11%), the reason for locating here was due to the commissioning body being located in Ireland.

Industry views and experience with S481 funding

5.18 Respondents were asked to provide information on the sources of production funding as well as their opinions on availability of S481 and their experience with it. Their opinions were also sought on the ability of a tax credit to match the benefit to them currently offered by Section 481.

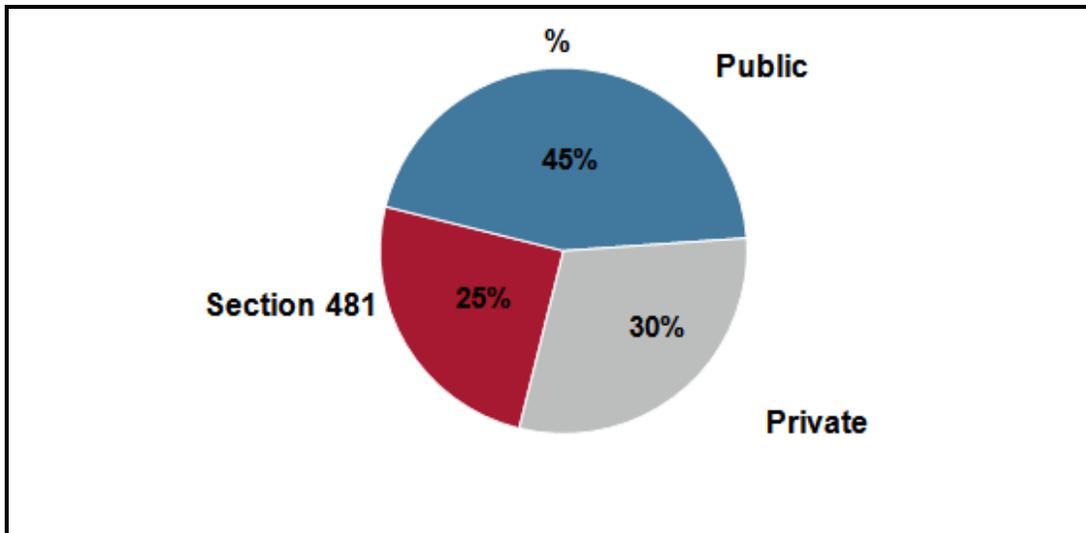


Figure 10: Sources of audiovisual production funding

Source: Survey of Audiovisual Producers

5.19 When all productions are taken into account (including those that did not use Section 481 Funding), public (non-S481) funding accounted for almost half (45%) of production funding with private funding accounting for a further 30%. Figure 10 above shows the percentage sources of audiovisual production financing.

5.20 In general, the availability of S481 funding is viewed quite well in the industry especially for its advantages in terms of cash flow relative to other types of film relief.

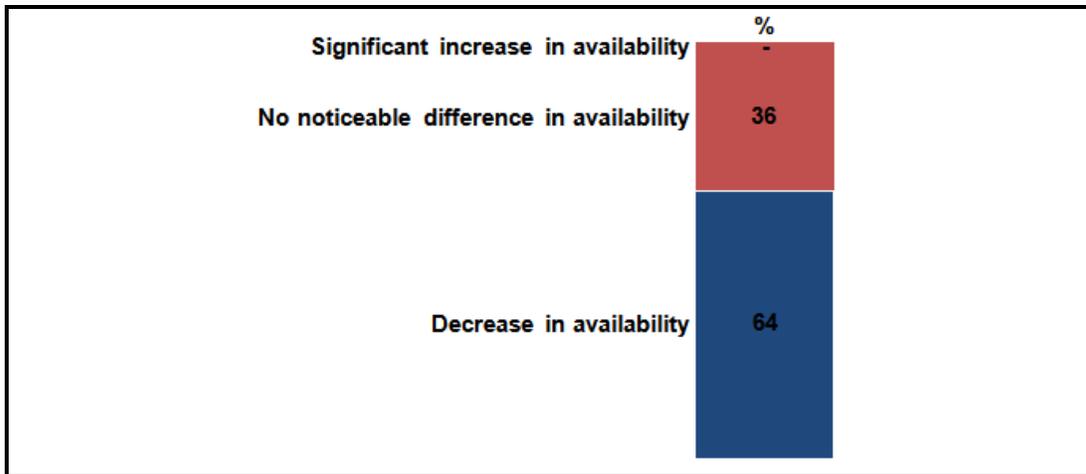


Figure 11: Availability of lending support from banks for Section 481 investors
 Source: Survey of Audiovisual Producers

5.21 Figure 11 above shows the perceived change in the availability of lending support from banks for S481 investors. The figure shows that 2 out of 3 audiovisual producers believe that there has been a decrease in the availability of lending support.

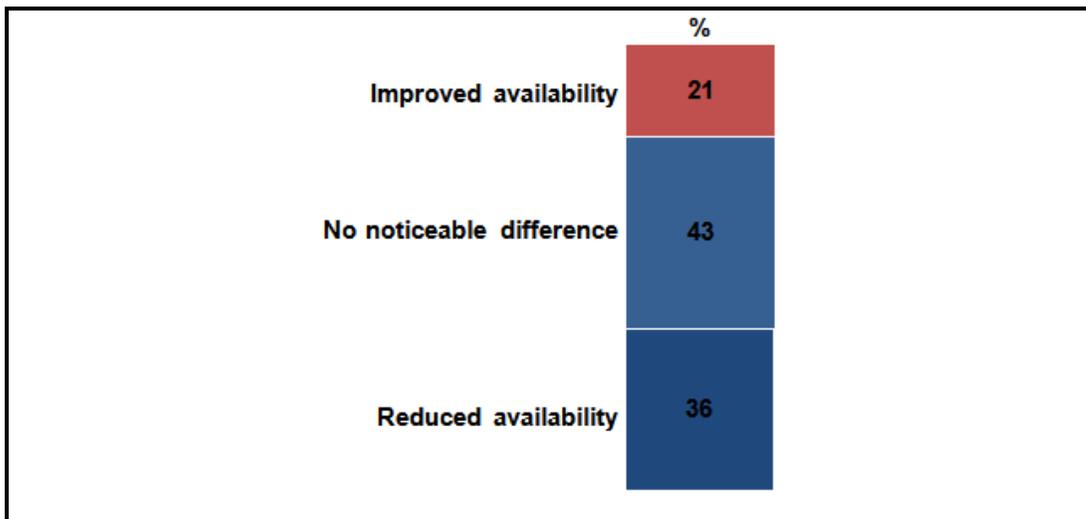


Figure 12: Perceived future trends in the availability of lending support from the banks for investors in Section 481 financing schemes
 Source: Survey of Audiovisual Producers

5.22 When asked about the likely future availability of lending support from banks for S481, 43% didn't expect to see any noticeable difference in the availability of lending support. The break down is represented above.

- 5.23 Of those for whom funding sources have become unavailable, the primary reason given was that Irish banks are no longer in this market, with specific reference made to Permanent TSB. References to Bank of Ireland and Anglo Irish Bank featured but to a lesser extent.
- 5.24 The survey also highlighted the role that professionals such as accountants play in the industry. All Section 481 Film Relief funding seems to be accessed through professional intermediaries such as accountants – highlighting the importance of this route in obtaining relief. There is no evidence of firms from the survey using direct marketing or advertising to access Section 481 funding for productions, although the avenue may be utilised by some.
- 5.25 In the Finance Act 2008 increased expenditure and investor caps whilst also allowing investors to take a tax deduction for 100% of their investment. Respondents were asked if they perceived an increase in the availability of Section 481 funding as a result. There was broad consensus that the provisions of the Finance Act 2008 had increased the availability of Section 481 funding.
- 5.26 Producers considered project cancellation the most likely result for both local and international productions if the Section 481 finance had not been available, especially for local productions (86% saying cancellation) whereas it would have less of a dramatic impact on international productions (57% saying cancellation).
- 5.27 The location of the production would also be negatively impacted if the Section 481 Finance was unavailable, particularly for international productions (29%) and to a lesser extent for local productions (21%).
- 5.28 Producers were asked about the adequacy of a tax credit matching the currently available benefit from the S481 relief. Over three quarters of producers did not believe that the benefit currently available through S481 could be financed through a direct tax credit. The common reason highlighted was the lack of upfront cash flow associated with a tax credit.
- 5.29 Although there was some acknowledgement that a tax credit could work in theory, there is little belief that it could work in practice. The general feeling was that a tax credit would have to be discounted at a cost to the producer so as to recure the necessary up-front cash flow for film productions. It was also noted that banks have been pulling out of financing in the industry recently and as such were unlikely to provide the lending service in the event that it was necessary.
- 5.30 As part of the survey BDO conducted in depth interviews with two large international producers. The interviews suggested that these larger international production companies would be open to some other format possibly, for example a transferable tax rebate system similar to the US which incorporates more flexibility into the provision of funds. They also identified that a wider range of eligible costs similar to that offered by the UK would be attractive. These two producers indicated that the upfront cash flow associated with S481 was not a critical aspect for their activities.
- 5.31 In addition, due to similarities in landscape terrain and architecture, many of international production companies consider Ireland and UK to be similar for film and television production. In many cases the interviewees noted that international production companies will conduct a comparison of the costs

and relevant tax reliefs available on a side by side basis before making a decision.

6. Outcome of review of international incentives

Introduction

6.1 This chapter describes the outcome of a review, conducted by BDO on behalf of the Department after a competitive tender,¹¹ of tax and non-tax incentives offered to the audiovisual sector in other jurisdictions. This review allowed the Department to better understand the operation of the scheme and the comparative efficiency and competitiveness of Ireland's offering. This review describes supports in 10 competitor jurisdictions:

- the UK;
- France;
- Belgium;
- Luxembourg;
- Australia;
- Czech Republic;
- Canada;
- New Zealand;
- Louisiana; and,
- Connecticut.

6.2 In addition to a discussion of the findings of the BDO review this chapter places special focus on developments in the UK and EU regarding audiovisual State supports. The UK recently initiated a public consultation on the extension of their relief to high-end television, gaming and animation. The EU Commission has also released a communication on state aid for films and audiovisual works which discusses the changing approach of the EU's state aid rules for film tax relief. The latter will affect the international context in which film support operates in Ireland for the short to medium term future.

6.3 The key findings from the BDO international review are:

- Tax credits to production companies are the most common form of support;
- Ireland and Belgium are outliers in offering reliefs to investors;
- A significant difference can exist between headline rates of relief and net benefits to producers;
- Jurisdictions can require a minimum level of expenditure before payment of the relief (e.g. new Zealand);

¹¹ The BDO report is published alongside this report as a supporting annex.

- Some jurisdictions have developed ways to monetise expected reliefs through interaction with national revenue authorities, financial institutions or other parties.

Key Findings of the Review

- 6.4 Film production support tends to be unique to each country yet can be broadly classified according to three types;
- Investor led relief where relief is offered to those individuals or corporations who invest in AV productions;
 - Producer led relief where relief is provided directly to the production company; and,
 - A grant based system which is a direct expenditure option with no tax element.
- 6.5 Box 1 displays countries according to the main type of support they offer.

| Investor Credit | Producer Credit | | Grants |
|-----------------|--------------------|-------------------|-----------------------|
| Belgium | UK | France | Czech Republic |
| Ireland | Australia | Louisiana | New Zealand |
| | Canada | Luxembourg | |
| | Connecticut | | |

Box 11: Method of support to the film tax industry

Source: BDO International Review of Film Supports

Investor Led Reliefs

- 6.6 Investor led relief allows the investors (individuals and corporates) to provide funds in a tax efficient manner to production companies, with producers having upfront access to their production funds. Of the ten countries surveyed only Belgium and Ireland employ this method of support to the film industry.
- 6.7 In Belgium the investor relief is only available to corporations. The maximum investment is much higher in Belgium at €500,000 than the €50,000 for individuals in Ireland but the actual amount of investment in an eligible production in Belgium is capped at a maximum of 50% of the cost of the production (80% in Ireland). Benefits of this system include the provision of up front access to funds and the placement of production risk on the investors of the scheme. However, it also dilutes the proportion of the tax support provided by the State which ultimately flows to the producer due to the need to recompense investors. In this respect it could be argued that it is a relatively inefficient model compared to other methods of film support.

Direct Producer Relief

- 6.8 The BDO review finds that direct producer led schemes are the most common supports to the audiovisual sector. Under direct producer relief, relief is provided to the production/co-production company. There are different mechanisms used by countries in granting relief such as directly in the form of tax deductions and payable tax credits, and indirectly by allowing secondary markets for the sale and/or transfer of tax credits.
- 6.9 Direct relief is given whereby eligible producers receive relief in the form of a direct tax deduction from the taxable profits of the company. Where there are no profits available to the company (a common accounting policy in the film industry or where the company is a special purpose vehicle) many jurisdictions such as Canada, the UK, and the state of Louisiana allow relief to be granted in the form of a payable tax credit i.e. a rebate.
- 6.10 A key issue with the producer led schemes is tax credits are generally received or applied for at the end of an accounting period and the support tends to be ex post rather than upfront payment received in investor led scheme. There are however ways in which companies can interact with tax authorities or financial institutions to monetise the relief at an earlier stage.
- 6.11 In jurisdictions such as the State of Louisiana and Luxembourg there are also secondary markets where tax credits can be sold to investors, who can use them to reduce their own tax liabilities. This benefits producers as it gives them timely access to their credits. Table 9 provides a breakdown of each of the countries employing a tax credit system according to whether they allow repayable credits and/or transferable credits in addition to the normal tax deduction.

| | UK | Connecticut | Louisiana | Australia | Canada | France | Lux. |
|----------------------------|-------------------------------------|-------------------------------------|-------------------------------------|-------------------------------------|-------------------------------------|-------------------------------------|-------------------------------------|
| Tax Deduction | <input checked="" type="checkbox"/> |
| Repayable Credit | <input checked="" type="checkbox"/> | | <input checked="" type="checkbox"/> | <input checked="" type="checkbox"/> | <input checked="" type="checkbox"/> | <input checked="" type="checkbox"/> | |
| Transferable Credit | | <input checked="" type="checkbox"/> | <input checked="" type="checkbox"/> | | | | <input checked="" type="checkbox"/> |

Table 10: Relief System by Jurisdiction

Source: BDO International Review of Film Supports

Grants

- 6.12 The governments of New Zealand and the Czech Republic offer financial assistance to film productions in the form of grants or rebates. Luxembourg is also changing its current tax based system of film support to this method of delivery in the near future.
- 6.13 The key benefit of a grant system is that the relief is given directly to the producer. It also provides certainty to the exchequer as to the annual costs of a scheme and therefore limits exchequer risk.
- 6.14 On the other hand, there can be a risk of subjectivity in the selection process. Grant aid also tends not to meet the cash flow needs of the

company given that funds are only released after film completion or an expenditure threshold has been met. Also, the level of competition for limited funds can mean that more experienced filmmakers win out in general however; this competition can also work to improve the quality of film output in the industry.

Headline Level of Reliefs to Companies

- 6.15 Comparing the benefits of reliefs across countries is difficult due to the three different methods of state support and the idiosyncratic application requirements of each jurisdiction as well as the variability of film productions. This means that often the commonly quoted headline reliefs are not a good measure of the net effective support realised by producers.
- 6.16 For example, in states where tax relief is applied to the producer in the form of a tax credit it is uncommon for there to be company profits to offset the tax credit against. As such the next available options for the film producer are to access the credit in the form of a rebate at a reduced rate from the government, discount it's cost using a bank (for a fee) or transfer it on the open market. All of which reduce the benefit to the film producer. The Table below gives the headline and net rates of relief under certain scenarios in Ireland, Louisiana and the UK.

| | Ireland | UK <£20m | UK >£20m | Louisiana |
|--|-----------------|-----------------|-----------------|-----------------|
| Headline Rate of Relief % * | 41% | 25% | 20% | 30% |
| Type of Relief | Investor Relief | Producer Relief | Producer Relief | Producer Relief |
| Immediate Benefit to Producer | 28% | NA | NA | NA |
| Benefit from Tax Deduction** | NA | 21.2% | 16.96% | 30% |
| Benefit from Repayable Credit | NA | 20%*** | 12.8% | 25.5%**** |
| Benefit for sale to Market/Broker | NA | NA | NA | 24% |

Table 11: Headline reliefs and net benefit to producers in selected jurisdictions

Source: BDO Review of Film Supports

* These are the figures normally referred to in discussion of film relief – in the case of Ireland this is the relief provided to the Investor on the higher rate of tax

** Assuming production company has sufficient profits to absorb full deduction

*** UK Repayable Credit based on enhanceable expenditure X Rate of enhancement X Payable credit rate (25/20%)

**** Assuming Buy-back in State of Louisiana at 85c/dollar

Targeted relief for the labour element of film production

- 6.17 In many countries tax support is tied to the level of local labour employed by the production. This is a targeted requirement given a significant policy goal of supports to film reliefs is job creation. This is the case in Canada where tax credits are primarily available at both Federal and Provincial level based on the value of local labour employed on a production. In other countries/states an additional benefit is provided over and above the base support to support the employment on local labour on productions. This is the case in the State of Louisiana which provides an extra 5% relief (Labour Tax Credit) for expenditure on local labour.
- 6.18 In the European countries examined there isn't an equivalent specific focus on labour; rather it is treated as one of the classes of expenditure which is recognised as qualifying expenditure under the tax provisions. This may be due in part to the requirement to treat local and EU labour in a consistent manner under European legislation

Monetisation and timing of relief access

- 6.19 A critical characteristic of state supports to the audio visual sector is the time till receipt of funds available under each method of support. In general, the timing is as follows;
- Investor based relief – majority of benefits accrues to producer upfront
 - Producer based relief – benefits accrue to producer after completion of a majority or the entirety of the production
 - Grants – varied benefit begins to accrue to producer after qualifying spend threshold is met or on submissions of audited accounts showing expenditure
- 6.20 Producers in all countries invariably look for early access to the benefit of their credits and reliefs to facilitate production cash flow, and in most countries have developed the means to deal with this demand. Threshold expenditure hurdles (e.g. New Zealand) allow funds to be released once expenditure in a country has reached a certain level. In cases where productions span over multiple accounting periods many countries (e.g. Czech Republic) allow application of the reliefs on expenditure up to the date of the accounting year end.
- 6.21 Lending against the value of a relief can be provided by the state (such as in Australia) or by private institution. In the case of Australia this facility is limited to productions with specific export arrangements. In the case of Louisiana the state will actually purchase back the relief at a discount at 85 cent on the dollar. A recent report prepared for the European Commission under their MEDIA programme found that Tax Credit based lending is relatively common and is provided by a small number of banks in Europe however,¹² it also finds that lending is regarded by banks as both complex

¹² Study on the Role of Banks in the European Film Industry 2009
<http://ec.europa.eu/culture/media/programme/docs/overview/evaluation/studies/sme/filmbanking.pdf>

and limited in scale, hence the report notes a reducing appetite for participation in this market.

Developments in UK supports to the audiovisual industry

- 6.22 The UK and Ireland are substitutable locations for filming given their common landscape, language and architecture as well as their general proximity. This means the level of state support is a key differentiator between the two locations which merits special attention.
- 6.23 The UK's Film Tax Relief is available to a Film Production Company (FPC) which is a company that is responsible for the pre-production, principal photography, and post-production of a film. It must also be engaged actively in production planning and decision-making during those stages as well as having responsibility for delivery of the completed film, negotiations, contracts and payments for rights, goods and services in relation to the film.
- 6.24 A key condition for claiming the relief is that at least 25 per cent of the 'core expenditure' on the film incurred by the FPC must be 'UK expenditure'. 'Core expenditure' means production expenditure on pre-production, principal photography and post-production. 'Production expenditure' means expenditure on film-making activities in connection with the film. 'UK expenditure' means expenditure on goods or services that are used or consumed in the UK.
- 6.25 To arrive at the amount of profits that are subject to corporation tax, a company deducts certain allowable expenditure from its taxable income. The FTR increases the amount of expenditure that is allowable as a deduction for corporation tax purposes which is called an 'additional deduction'. The additional deduction reduces the taxable profits of a FPC, or turns a taxable profit situation into a loss situation or increases the losses of a FPC.
- 6.26 The additional deduction is based on enhanceable expenditure. Enhanceable expenditure is the lower of:
- UK core expenditure; or,
 - 80 per cent of total core expenditure.
- 6.27 Where the additional deduction creates a loss, the FPC can surrender the loss for a payable tax credit. A payable tax credit means that the FPC will receive a cash payment from Her Majesty's Revenue and Customs (HMRC). The levels of the additional deduction and payable tax credit are dependent on the size of the film's budget. For a limited-budget film (one whose core expenditure is £20m or less) the additional deduction is 100 per cent of enhanceable expenditure and the payable tax credit is 25 per cent of losses surrendered. For other films, the rates are 80 per cent and 20 per cent, respectively.

6.28 Based on the size of the production and how the relief is availed of, the effective range in net value of the Film Tax Relief is between 12.8% and 21.2% of UK Core Expenditure. Table 12 below outlines scenarios for High and Low budget film productions (films greater or less than £20m) by whether or not the FPC turns a profit.

| Notes | Low Budget (<£20m) | High Budget (>£20m) |
|--|--|---|
| Additional Deduction: FPC has sufficient profit to absorb full value of additional deduction | <ul style="list-style-type: none"> Enhanceable expenditure = 80% of total expenditure Rate of enhancement = 100% UK Corporation Tax Rate = 26.5% <p>Value of FTR: = 80% x 100% x 26.5% = 21.2%</p> | <ul style="list-style-type: none"> Enhanceable expenditure = 80% of total expenditure Rate of enhancement = 80% UK Corporation Tax Rate = 26.5% <p>Value of FTR: = 80% x 80% x 26.5% = 16.96%</p> |
| Payable Credit: FPC has no taxable profits (but no loss) and claims maximum amount of Payable Credit | <ul style="list-style-type: none"> Enhanceable expenditure = 80% of total expenditure Rate of enhancement = 100% Payable credit rate = 25% <p>Value of FTR: = 80% x 100% x 25% = 20%</p> | <ul style="list-style-type: none"> Enhanceable expenditure = 80% of total expenditure Rate of enhancement = 80% Payable credit rate = 20% <p>Value of FTR: = 80% x 80% x 20% = 12.8%</p> |

Table 12: Net benefit to producers in UK

Source: BDO Review of Film Supports

* The above example is based on a HRMC example which has been updated for consistency and to reflect the new corporation tax rates¹³

** It should be noted that as per the Notes, the above assumes no loss is made before the adjustment for enhanceable expenditure. An operational loss within the FPC may impact on the percentage value of the FTR.

6.29 The UK Government has announced its intention to extend the system of relief available to film in the UK to the creative sectors. The term 'creative sectors' covers animation, high-end TV and video gaming. In preparation for the introduction of the new scheme of relief in April 2013, the UK Government announced the launch of a consultation process which began in June 2012

6.30 The new reliefs for these creative industries are to be closely modelled (in operation and as regards the level of reliefs provided) on the existing support schemes for the film industry. However they are to be distinct and separately tailored to the requirements of each of the creative industries.

¹³ <http://www.hmrc.gov.uk/manuals/fpcmanual/FPC55030.htm>

- 6.31 For each of the three named creative industries a working group has been established to discuss the necessary design of the particular relief. Although the relief is based on the structure of the current film tax relief there still remain several areas for discussion which are briefly addressed below.

High-End Television

- 6.32 Changes to the UK's approach to support for the TV sector are aimed particularly at high-end television. A monetary threshold restriction of £1 million per hour of TV is being proposed which would target higher end television. Several areas are under review by the special working group and the working group are considering what might be the direct costs of production and what should be excluded (e.g. costs of finance and marketing) and what production types are high end (drama, comedy etc.) and those which are not (current affairs, discussion, variety, panel shows etc.)

Animation

- 6.33 The target of the animation tax relief are producers of animated programmes for television broadcast, which is the dominant platform for showing animated content. It is proposed that the animation tax relief adopts a similar model to the Film Tax Relief. It has all the same requirements to meet the definition of a film, intention to be broadcast, pass a cultural test, and have 25% of the goods and services which form part of core expenditure consumed in the U.K. A separate rule is to be introduced to separate genuine expenditure pertaining to long lead-in times to production and speculative expenditure that doesn't end up producing a product. One approach under consideration would be for early stage costs associated with a specific project to become eligible for relief once the programme has been formally commissioned by a broadcaster.

Video Games

- 6.34 International supports to the video game industry are in general quite different in structure and form to those which support other audiovisual sectors such as film and TV. As such the consultation surrounding the gaming sector faces a number of challenges in deciding what form the relief might take. As with the other working groups, a number of specific priority areas have been identified which need to be addressed.
- 6.35 The definition of video games is proposed to follow that of the French model of support to the video games sector. There is a discussion as regards how to structure the relief; whether it should be similar in form to the current French scheme or the system of R&D tax credits currently running in the UK. It also considers the treatment of product based companies or service based companies such as software application developers and online gaming. An agreement needs to be decided on what should be included in 'core expenditure' – there is a focus on development costs and the exclusion of debugging and maintenance costs and how 'core expenditure' could be expanded to include further significant development of a game after the game has been delivered.

EU Communication on state aid to film and other audiovisual works

- 6.36 In view of a number of different trends which have emerged since 2001, the EU Commission has released a communication which is focused on increasing the availability of nationally focused films across the E.U. by:
- extending the scope of activities covered by the Communication to include all aspects from story concept to delivery to the audience;
 - limiting the possibility to impose territorial obligations on production expenditure;
 - controlling the competition between Member States to use State aid to attract inward investment from major third country productions; and,
 - discussing initiatives aimed at improving the circulation and increasing the audience of European films for the benefit of the European audiovisual industry
- 6.37 This Commission feels that the fragmentation of the European audiovisual sector into national markets is built into the public support for European audiovisual works, with which national, regional and local funding schemes subsidise many small production companies. Changing this status quo is the focus of the new initiatives.
- 6.38 The Commission has revised its stance that provision of aid to a film allows the state in question to place constraints on up to 80% of the overall budget. The commission is now of the opinion that the amount of expenditure which is tied by territorial conditions should have at least a proportional relation with the amount of the actual financial commitment of a Member State and not with the overall production budget. Furthermore, the communication proposes that audiovisual support schemes in which the aid intensity is based on the production expenditure in a given territory, such as film tax incentives, allow any production expenditure within the EEA to be eligible.
- 6.39 Consistent with the top down view the Commission is taking on European cinema the Commission views competition occurring among member states to attract non-EU investment an unwelcome development. This intention going forward is to develop a different standard for "European Works" (defined in the annex to the communication) and other non-European films which would limit this.
- 6.40 In addition, in response to the extension by many states of aid to audiovisual activities of script-writing, development, and film distribution and promotion the commission now intends to support these efforts with the purpose of spreading cinema outside national borders across the E.U.

7. Economics of Section 481

- 7.1 This chapter looks at the economics of Section 481 with a focus on how the relief operates in practice, how investors are remunerated, how risks are borne and by whom as well as the efficiency and equity of the scheme as currently structured.
- 7.2 A quantification of the economic costs and benefits of the scheme are described in chapter 8.

Structure of the relief

- 7.3 Section 481 relief is an ex ante support to audio visual productions. The relief operates in a way that provides up front financing to production companies by third party tax-investors.
- 7.4 Special purpose vehicles established for the purposes of making a Section 481 financed production may raise up to 80% of qualifying expenditure from tax investors, subject to a maximum cap of €50m. Investors themselves may invest a maximum of €50,000 and use 100% of their investment as a shelter against tax at their marginal rate.
- 7.5 The primary benefit to a producer of a tax incentive (tax expenditure) system as against a grant based (direct expenditure) system is its flexibility. Unlike grant schemes tax relief is flexible to changes in activity. Under a grant system the level of annual grants are usually capped in the Government's annual budget. In a tax relief system when activity increases the system responds linearly to the increase. However the downsides for the exchequer of a tax expenditure are the risk of leakage, whereby a gap emerges between the cost to the exchequer and the benefit to the intended beneficiary, the open ended nature of a tax expenditure, and the lack of certainty over expected costs.
- 7.6 Broadly speaking two models of tax relief exists, an income tax 'investor-led' approach and a tax credit producer led approach. Section 481 is an income tax investor led model. The benefit of this approach to production companies is substantial as it means that 80% of qualifying production costs (namely expenditure on materials and services and EU labour) are received from investors up-front. The benefit to the bodies who commission productions (e.g. TV networks or studios) is the difference between what the production companies raise from tax investors and what the commissioning body pays to remunerate investors. In Ireland this difference is 28% and is described below.
- 7.7 The alternative tax-credit based approach which is favoured internationally involves some form of ex-post claim for a tax credit by the production company after expenditure has been incurred. In order for the value of the credit to reduce the cost of commissioning the production, in the manner that Section 481 does, parties must monetise the value of the credit for example by interacting with a financial institution by discounting the face value of the credit. Alternatively the State could provide an up-front payable credit to the production company.
- 7.8 In Ireland participating tax investors purchase shares in the special purpose vehicles (SPV) and are remunerated by the SPV upon satisfactory

completion and delivery of the production to the body that commissioned the work (e.g. a TV network). The investor's total return from the investment is the sum of the remuneration from the SPV and tax relief at the investor's marginal rate.

- 7.9 Investors who invest the maximum of €50,000 will receive a tax benefit of €20,500. This is usually received within the same year as the investment. The investor's remuneration from the SPV is based on a structure known as a 'defeasance model' which is described below.

The defeasance model

- 7.10 The defeasance model involves an SPV raising 80% of qualifying expenditure in funding from tax investors with a simultaneous deposit of 72% of this amount by the body that commissioned the production into a defeasance account. The money in the defeasance account is released to the SPV if the production is completed and delivered and the SPV releases the defeasance payment back to the investors.

- 7.11 Investors therefore receive 41% of their investment back in the form of tax relief and 72% from the defeasance approach, resulting in an approximate total remuneration of 113% or a return of 13%. This approach is described in the diagram in Figure X below which is based on a €100 investment by a tax investor.

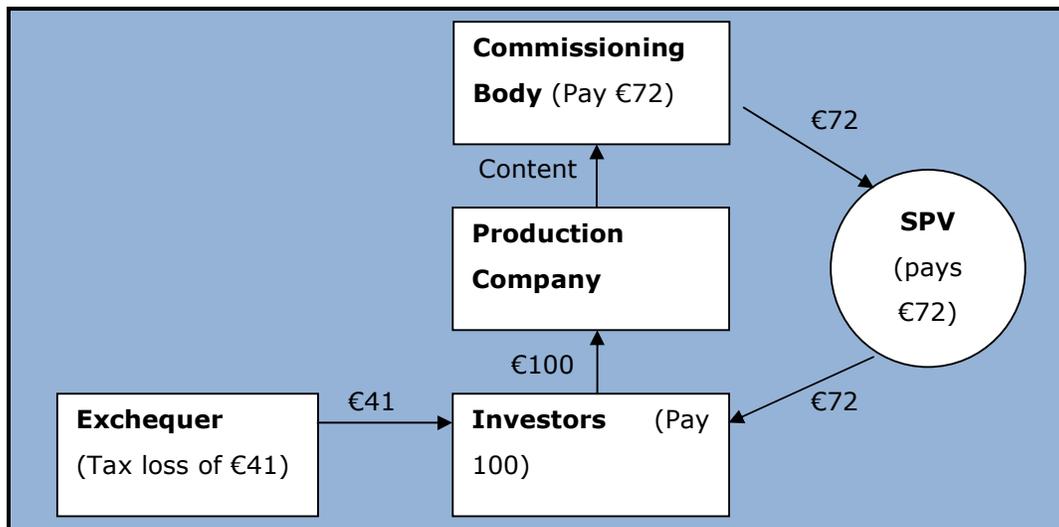


Figure 13: Stylised financing structure
Source: Department of Finance

- 7.12 In the stylised example above investors provide €100 in financing to the SPV. The €100 therefore represents the production's Section 481 financing requirements.

- 7.13 Once approval has been received from Revenue the commissioning body, for example a TV network, deposits €72 in a defeasance account for remuneration of the investors. Investors also receive 41% relief on their €100 investment. The sum of the remuneration from the defeasance account and the tax relief is the total remuneration to the investors and sums to €113 or a 13% return.

7.14 A worked example of the defeasance model is described below. In this example the total production budget is €10m with the full 80% of the budget raised through Section 481

| | |
|----------------------------------|--------|
| Production Budget | €10m |
| S481 Investor Finance | €8m |
| Non S481 Funding | €2m |
| Total Funding | €10m |
| <u>Producer Benefit</u> | |
| Budget | €10m |
| Non S481 Funding | €2m |
| Defeasance (72% of S481 Finance) | €5.76m |
| Total cost to producer | €7.76m |
| Producer's net benefit | €2.24m |
| Producer benefit as % of S481 | 28% |

Box 12: Stylised example of producer net benefit

Source: Philip Lee Solicitors

Risk and return

7.15 There are obvious benefits to this approach in terms of timing and risk. For the production company the benefit of the approach is an up-front payment. For the body that commissions the content the cost of production is 72% of qualifying expenditure – the amount paid into the defeasance account – rather than 100%. The Irish model therefore results in a benefit to the producer of 28%.

Allocation of risk

7.16 Another benefit is the allocation of risk. The funds on deposit in the defeasance account are not released to the SPV and thus the investors unless the production is satisfactorily completed and delivered. If the production fails the defeasance is instead returned to the commissioning body and the investors are not remunerated. Investors therefore bear full commercial risk rather than the commissioning body. Thus as well as receiving a 28% benefit the Irish model transfers risk to the investors. Of course the body that commissioned the production bears ex post commercial risk.

7.17 While investors do bear risk, it should be noted that in practice the risk is very low. The Department has not been made aware of any instances of failures to complete productions in recent years. It should be noted however that the Irish Tax Institute have suggested there exist instances where industry participants have supported troubled productions to ensure completion, however documentary evidence was not provided to support these claims nor was this issue raised in other submissions. In any event

such a practice does not depend on the continued operation of a defeasance model and could continue in a credit-based or other incentive system

- 7.18 The Department has reviewed marketing literature by promoters of Section 481 investments and it is clear that these schemes are marketed as an attractive investment for risk averse investors with one promoter stating in 2010 that the structure “makes it a very attractive investment for risk averse investors”.¹⁴
- 7.19 Whilst the defeasance approach can result in an investor earning a return of 13% on a full investment of €50,000, corporate finance investors have devised a method of using leverage in combination with the defeasance model to increase the return to the investor.
- 7.20 Consider the following example as presented by Horwath Bastow Charleton (HBC) in its submission and as used in a well-known production in 2010.

| Production: Incoming TV drama, 2010 | |
|--|----------------------------|
| Promoter: HBC | |
| Required equity | €16,600 |
| Pre-approved loan from domestic bank | €33,400 |
| Total investment | €50,000 |
| Tax relief | €20,500 = €50,000 @ 41% |
| Total payoff on equity | €3,900 = €20,500 - €16,600 |
| Total return on equity | 23.5% |
| In this situation the pre-approved loan is fully paid off at year end by the money on deposit in the defeasance account. | |

Box 13: Example of investor return
Source: HBC

- 7.21 In the example above an Irish financial institution acts an intermediary in facilitating investors to leverage up from a small investment whilst receiving the maximum tax relief. Despite the investor only providing €16,600 in capital the pre-approved loan that is later fully repaid with the proceeds of the defeasance brings the effective amount of investment to €50,000. The investor’s tax relief of €20,500 exceeds their actual investment by €3,900.
- 7.22 Depending on the timing of the investment some tax payers may receive their tax relief within ten weeks. It should be stated that the investor would be liable for the €33,400 loan if the production is not satisfactorily produced and delivered, however as discussed above this is a very low probability event and which in practice has not occurred.

¹⁴ Section 481 Film Investments, Corporate Finance Promoter, 2010

- 7.23 It would also be possible for investors to borrow their equity investment from a financial institution however the financing cost would reduce the total yield.
- 7.24 A 23.5% return in a ten week period is a particularly attractive investment for any investor and compares favourably with many retail investments. It may also divert participation away from the State Savings Scheme or other equity based tax incentives, a point that is returned to below.
- 7.25 A key issue for fiscal policy is whether the perceived high return, low risk, and relatively quick remuneration diverts investors away from other incentives. Another equity based incentive is the Employment and Investment Incentive (EII), which was previously known as the Business Expansion Scheme (BES).
- 7.26 The EII is targeted at medium-sized enterprises operating in what are known as the "non-assisted areas" of Ireland and which are in their seed/start-up phase of development. These companies are regarded as crucial to the domestic economy and the equity assistance they receive from tax investors is important given the credit constrained nature of the economy and the natural risks in terms of probability of default of small and medium enterprises in terms of lending rules and credit risk.
- 7.27 Whilst investors may invest up to €150,000 per annum, relief is only available at 30% with an additional 11% if it has been proven that employment levels have increased at the company at the end of the holding period (3 years) or where evidence is provided that the company used the capital raised for expenditure on research and development.
- 7.28 Start-up companies in the SME sector may be regarded as high risk. Given the perception of Section 481 as a low risk investment suited to risk averse investors, there is a risk that Section 481 might crowd-out investment in the EII scheme. The data below illustrates the similarity in investor profiles in the BES scheme (now the EII) and Section 481 in 2010.

| Income level | Business Expansion Scheme | | Section 481 | |
|-----------------------|---------------------------|-----|-----------------------------|-----|
| | Share of number of claims | | Share of size of investment | |
| Less than €100,000 | 334 | 29% | 912 | 26% |
| €100,000 - €150,000 | 266 | 23% | 964 | 28% |
| €150,000 - €200,000 | 142 | 12% | 582 | 17% |
| €200,000 - €275,000 | 129 | 11% | 421 | 12% |
| Greater than €275,000 | 269 | 24% | 604 | 17% |
| Total | 1,140 | | 3,483 | |

Table 13: Percentage share of claims and maximum cost by income band in 2010

Source: Department of Finance analysis of Revenue data

- 7.29 It is clear from the distribution of investor incomes across income groups is very similar for both schemes. This would suggest that there is a genuine

risk of a crowding out effect occurring if investors regard Section 481 as a low risk-high return proposition relative to EII.

Efficiency of the Incentive

- 7.30 As discussed above a network or other body can commission a production in Ireland at a cost of 72% of the total qualifying expenditure incurred in Ireland in making the production. Thus a net benefit of 28% accrues to that party.
- 7.31 However the cost to the exchequer in providing this benefit is not 28% of qualifying expenditure but rather 41%, as tax relief is provided to investors at their marginal rate against the full amount of their investment. The 13% leakage from the exchequer contribution – which equates to 32% of the exchequer contribution – is highly inefficient particularly in light of the current fiscal deficit. It should be noted that leakages tend not to occur under a direct expenditure model.
- 7.32 Whether the cost to the exchequer represents good value for money in light of economic activity and tax gains generated by the scheme are discussed in chapter 9 in the cost benefit analysis.

Equity of the scheme

- 7.33 The data presented in chapter 3 illustrated the cohort of claimants for tax relief under Section 481 in 2010 with income in excess of €100,000. It is clear from the data that this is a relief that is highly popular with higher income earners and therefore may be inconsistent with the Government's commitment in the programme for Government reduce cap or abolish tax shelters which benefit very high income earners.
- 7.34 Given that the payoff of the relief is dependent on the remuneration from tax relief rather than from the investment itself it is clear that this structure ensures that it is high income earners that participate in the incentive.
- 7.35 In a submission in response to the consultation paper Deasy Advisory Services calculated that an individual must have income of at least €12,500 at the higher rate, or €45,300 gross, in order to participate in the scheme. This therefore precludes many middle and lower income earners.
- 7.36 The Commission on Taxation also stated that the structure of the relief and the manner in which it may be used raised a question of equity with those lower down the income scale less likely to have the initial capital to leverage a loan in order to avail of the relief.
- 7.37 It is clear for these reasons that the tax relief is inherently inequitable as it is not accessible to individuals on the standard rate of tax and individuals with income of less than €12,500 taxable at the higher rate.

8. Cost benefit analysis of Section 481

Introduction

- 8.1 This chapter sets out the results of the Department's cost benefit analysis (CBA) assessment of the Section 481 relief. In doing so it takes account of evidence presented by other parties during the course of the consultation process.
- 8.2 The Department's CBA model is based on the official model used by the industrial development agencies,¹⁵ and is in line with the CBA guidelines of the Department of Public Expenditure and Reform (D/PER).¹⁶ The model benefits from actual tax data from the Revenue Commissioners on tax receipts and costs associated with Section 481, as well as expenditure data from Revenue and the Irish Film Board.
- 8.3 The Department's CBA finds a significant net welfare loss arising from the scheme under the baseline scenario. This chapter presents sensitivities to the baseline and demonstrates that a net gain only arises under extreme scenarios.
- 8.4 A cost benefit analysis was also presented by Indecon Economic Consultants on behalf of IBEC. The Indecon approach reports a small net benefit from the scheme however the approach adopted by Indecon departs from the official guidelines and includes a number of inputs on the benefits side that the Department does not agree with.

Cost benefit analysis

- 8.5 The general principle of cost benefit analysis is to assess whether or not the social and economic benefits associated with a project or scheme are greater than its costs. To this end, a project is deemed to be desirable where the benefits exceed the costs.
- 8.6 In cost-benefit analysis all of the relevant costs and benefits that the project gives rise to, including indirect costs and benefits, are taken into account insofar as possible. Monetary values, based on market prices (or shadow prices, where no appropriate market price exists) are placed on costs and benefits. The general principle of cost-benefit analysis is that a project is desirable if the economic and social benefits that it gives rise to exceed the value of the resources consumed by the project. It is important that only benefits that result directly from the project or scheme in question are taken into account and that any costs associated with these benefits are fully accounted for in the appraisal.
- 8.7 Before describing the model and the results, a number of key economic concepts relating to cost-benefit analysis are described below.

Shadow prices

- 8.8 The resources consumed by the project should be valued at their opportunity cost, i.e., the value of these resources in their next best

¹⁵ See 'The economic appraisal system for projects seeking support from the industrial development agencies', by Murphy, Anthony; Walsh, Brendan M.; Barry, Frank, Forfás, 2003

¹⁶ See 'Guide to economic appraisal: Carrying out a cost benefit analysis', Public Spending Code, Central Expenditure Evaluation Unit, Department of Public Expenditure and Reform.

alternative use. For example, while the additional wage income generated by an increase in employment arising from a project can be treated as a benefit, account must be taken of the opportunity cost of labour, i.e., the wages that labour would earn in the market in the absence of the scheme. In a CBA framework only the benefit above the opportunity cost is treated as a net benefit.

- 8.9 It is generally recommended that market prices are used to value the cost of inputs as these best reflect the opportunity cost involved. Market prices are generally reliable and verifiable. However, in some cases market prices do not reflect opportunity costs due to market failures. Shadow prices may then be used. Some key shadow prices used in the analysis of Section 481 are:
- The shadow price of public funds, which reflects the distortionary impact of taxation; and,
 - The shadow price of labour, which accounts for the opportunity cost of the labour used in the activity.

Shadow price of public funds

- 8.10 The price of public funds adjusts the tax (or public expenditure) cost of a scheme or project to account for the cost to society of the tax imposed to finance the scheme. Taxation gives rise to economic distortions by altering the incentives facing economic agents, leading to changes in their behaviour (for example reduced labour market participation) and reduced economic activity.
- 8.11 It is an accepted principle of public finance theory that additional taxes impose costs on the economy in the form of distortions/disincentives and therefore every €1 of additional public spending has to generate more than €1 benefit to be deemed worthwhile. The same logic implies that every additional €1 in tax revenue attributable to a project should be treated as worth more than €1 on the benefit side of the calculation.
- 8.12 For this reason, the shadow price of public funds is greater than one. A premium must be attached to the nominal costs of the scheme in order to make private cash flows commensurate with public cash flows and account for the deadweight loss of taxation. If public costs and private benefits are treated equally, the benefits of a scheme would be overstated. Economic theory suggests that the distortionary costs of taxation vary roughly in line with the square of the marginal tax rate. The elasticity of labour with respect to taxation is also a factor in the parameter estimate.
- 8.13 In terms of an actual parameter estimate, Patrick Honohan estimated a shadow cost of public funds in the range of 150%-200% (and in some cases in excess of 200%) in the 1980s.¹⁷ Honohan later revised this estimate to 150%.¹⁸ Honohan's views related to the high marginal tax rates in Ireland at the time of his research and the high elasticity of labour supply. Research by a team of economists on behalf of Forfás in 2003 reviewed the shadow cost of public funds.¹⁹ In noting the reductions in marginal tax rates since

¹⁷ See 'The marginal social cost of taxation in Ireland', Honohan, Patrick, 1987

¹⁸ See 'Methodological Issues in Evaluation of Irish Industrial Policy', Honohan, Patrick, ESRI Working Paper No 69, ESRI, 1996

¹⁹ See 'The economic appraisal system for projects seeking support from the industrial development agencies', by Murphy, Anthony; Walsh, Brendan M.; Barry, Frank, Forfás, 2003

Honohan's 1997 review, they proposed a shadow cost of public funds of 125%.

- 8.14 Given the increase in marginal tax rates in the interim, where the highest marginal rate is now approximately 52% for private sector workers (and 55% for self-employed individuals with income in excess of €100,000), it is likely that the shadow cost of public funds has increased from 125% since the Forfás review. Whilst the distortionary effects of taxation depend on more than marginal income tax rates – distortionary effects are felt across other tax heads and in labour supply – it is reasonable to adjust the shadow cost of public funds to account for the increase in marginal tax rates since the Forfás review.
- 8.15 Official guidance is available from the Department of Finance's 'Working Rules for Cost Benefit Analysis' and recent guidance by the Department of Public Expenditure and Reform which recommend a shadow price of 150%.²⁰
- 8.16 Taking account of the discussion above and having regard to the official guidelines of the Department of Public Expenditure and Reform, a parameter value of 150% is therefore selected.

Shadow price of labour

- 8.17 The principal traditional justification for grant assisting employment creation has been to reduce the level of involuntary unemployment. To allow for the fact that involuntary unemployment is not reduced one-for-one by each job created, the market wage is replaced in a CBA model by a shadow wage which reflects the opportunity cost of labour.
- 8.18 Honohan (1996) estimated a shadow wage rate of 80%. This implies out of every £100 of a project's domestic wage bill, £80 is required to elicit the supply of labour, which is an opportunity cost, while the remaining £20 is the value attached to the reduction in involuntary unemployment, which is a net economic gain. In a fully employed economy the market wage is the same as the shadow wage, i.e., no net economic gain is attributed to generating employment per se.²¹

"Even if the social cost of employing an unemployed person were zero, the estimated impact on job creation on unemployment from the male quarterly data would not justify shadow prices much below 80 per cent" (Honohan, 1996)

- 8.19 Forfás (2003) argued that the low unemployment and high net immigration rates at the time implied that the opportunity cost of an additional employee was close to the market wage, on the basis that there was no significant reservoir of involuntarily unemployed people in the economy at the time. The choice of shadow wage in the Forfás model therefore reflected the belief that in most situations the market wage – or something very close to it – was necessary to elicit additional labour supply. Forfás therefore applied a

²⁰ Guide to economic appraisal - carrying out a cost benefit analysis, Department of Public Expenditure and Reform

²¹ An exception is where the jobs created are at above average wage levels; in these circumstances the shadow wage is adjusted to take account of the economic benefit from the wage premium.

shadow wage rate of 100% for projects located in Dublin, 95% for the rest of Ireland, and 90% for the Border Midlands and Western region (BMW).

- 8.20 Given the increase in unemployment since 2003 from 4.5% to 14.9% it is worth revisiting these assumptions. Guidance is provided by the authors of the Forfás report on how to adjust the shadow price of labour in response to changes in the unemployment rate.
- 8.21 The authors accepted that a sustained increase in the unemployment rate could justify a reduction in the opportunity cost of labour (or the shadow wage) recommending that the shadow price of labour should be reduced by two percentage points for every percentage point by which the unemployment exceeds 6%.
- 8.22 Based on an unemployment rate of 14.9%, which exceeds the threshold rate of 6% by just under 9 percentage points, the shadow wage rate should be reduced by 18%. For the purposes of this analysis the base rate that the reduction is applied to is the "rest of Ireland rate" of 95%.
- 8.23 Using the Forfás approach, a shadow cost of wage rate of 77% would be used. As this estimate does not differ markedly from Honohan's (1996) minimum recommended parameter value of 80%, the Department uses a parameter of 80% in this analysis.
- 8.24 The Forfás model uses a lower shadow price for the component of labour accounted for by immigration and increased labour force participation. It is therefore valid to regard a fraction of the opportunity cost part of the wage bill as a net addition to GDP. Whilst the wages are an opportunity cost, and should therefore be shadow priced, the taxes paid on this proportion of the wage bill (grossed up by the shadow price of public funds) should be included as a benefit.
- 8.25 Forfás recommend a value of 55% for the 'rest of Ireland' for this parameter, referred to as lambda in the model. In following the Forfás model, the Department has included this value in its model. This implies that one half of the taxes on the opportunity cost component of the wage bill should be treated as net additional tax revenue (i.e., a benefit for CBA purposes)

Scheme Deadweight

- 8.26 The overall benefits associated with a grant scheme should be adjusted if some, or all, of the grant-aided activity would have occurred in the absence of the support. Honohan's research in 1997 suggested that 80% of the benefits attributable to grant-aided projects would have happened anyway, with the effect that only 20% of the benefits should be attributed to the grant expenditure.
- 8.27 While it may seem extreme to believe that only 20% of grant expenditure has any impact on the location of investment, this parameter reflects two factors; firstly, the possibility that a firm would have located in Ireland without any grant-aid, and; secondly, the possibility that some grant aid is required but not as much as is actually given. The Forfás model (2003) reaffirmed a grant deadweight of 80% but made some downward adjustments for regions outside Dublin and for firms in various stages of expansion with a lower deadweight of 60% applied to high potential start-ups.

- 8.28 In estimating a deadweight parameter a number of methods are proposed by Honohan and Forfás including surveys, econometric techniques and control/treatment groups. The drawback with interview studies is that executives generally have no particular incentive to truthfully reveal what they would have done if their project had not received assistance or had received a lower level of assistance. For this reason the surveys by Amárach and Indecon are not relied on extensively in formulating a deadweight estimate. Econometric studies are more sophisticated but require a lot of data.
- 8.29 Control/ comparison group studies are probably the most convincing. These studies look at differences over time in the performance of assisted firms relative to the performance of similar non-assisted firms. Since the vast majority of audiovisual projects are Section 481 funded, we lack a control group of non-Section 481 funded firms that could be used to assess the impact of relief.
- 8.30 The approach used here is to assume that the level of deadweight for incoming productions is low. This is reflective of the competitive international environment and is consistent with the findings of the Amárach survey, the BDO review and views on deadweight expressed by Indecon and the Irish Film Board. Accordingly, the Department assumes a 10% deadweight factor for incoming productions.
- 8.31 Regarding domestic productions, as described in chapter 7 above, Section 481 provides a net benefit of 28% to production companies. Thus even with Section 481, 72% of the cost of qualifying expenditure must be still be raised by the production company. Whilst in the extreme it could be argued that the 28% benefit would be lost in its entirety it is not clear why the remaining 72% would not be available to the industry in the absence of Section 481. It is therefore assumed that an overall deadweight of 72% should be applied to the benefits that are attributable to local production.
- 8.32 The overall scheme deadweight is the weighted average of the incoming and the local deadweight factors, weighted by their respective shares of qualifying expenditure in 2011 (46% and 54% respectively). The overall deadweight is therefore estimated to be in the range of 35% to 40%.
- 8.33 A point estimate for the overall scheme deadweight is 35%. This is significantly below the lowest deadweight value of 60% in the Forfás appraisal model relating to high potential start-up companies.

Multiplier effects

- 8.34 Multiplier effects are taken account of in the model through the inclusion of indirect wages and taxes as benefits of the scheme. Indirect wages relate to the wages earned by labour on the production of materials and the provision of services to Section 481 productions. Indirect wages are calculated by applying a multiplier to the expenditure by Section 481 companies on 'materials and services'.
- 8.35 The multiplier used is sourced from the 'Supply and Use Input Output Tables' of the Central Statistics Office.²² The input output tables do not

²²

http://www.cso.ie/px/pxeirestat/database/eirestat/Supply%20and%20Use%20and%20Input%20Output%20Tables/Supply%20and%20Use%20and%20Input%20Output%20Tables_statbank.asp

contain multiplier value for the audiovisual sector. Instead the multiplier for the 'Other Services' sector is used.

- 8.36 A multiplier of 1.6 is used, which indicates that for every Euro spent on materials and services a further €0.6 is spent on labour.
- 8.37 The Indecon analysis takes account of 'induced' multiplier effects. Induced effects relate to the additional economic activity that might result from the expenditure of the direct and indirect wage income in the general economy. Induced effects are not included in the official models of Forfás or the Department of Public Expenditure and Reform and are thus not included here. Induced effects are by their nature a second or possibly third order effect and are thus at a distance from the scheme. It is therefore conceptually difficult to distinguish these benefits from benefits that would accrue from alternative outlays (e.g., if instead of aiding the audiovisual sector that State were to directly distribute the same amount of cash in lump sums to a randomly selected cohort of individuals).
- 8.38 It should also be noted that previous official Department of Finance guidance cautions against the inclusion of induced effects in CBA studies.²³ The Department's view was that indirect effects should be estimated using multiplier based on the CSO's input-output tables, and that induced effects "should not be included in the analysis unless it is demonstrated that they have been calculated on the basis of a rigorous methodology using data for the Irish economy". As no such methodology is available, the Department does not believe that a case has been made for the inclusion of induced effects.

Summary of parameter estimates

- 8.39 The parameter estimates used by the department in this CBA are summarised below. For comparison purposes and in the interests of transparency, the parameter estimates used in the Indecon CBA - cited by a number of respondents to the Department's consultation - are also included. The parameters from the Forfás model used by the Department are also shown.

²³ Proposed working rules for Cost-Benefit Analysis, Community Support Framework Evaluation Unit, Department of Finance, 1999

| Parameter | Forfás | Department of Finance | Indecon | |
|--|----------------------------|-----------------------|---------|-----|
| Shadow price of public funds | 125% | 150% | N/A | |
| Shadow wage rate | Greater Dublin | 100% | 80% | 10% |
| | Rest of State | 95% | | |
| | BMW region | 90% | | |
| Proportion of shadow wage rate attributable to immigration | Greater Dublin | 50% | 55% | N/A |
| | Rest of State | 55% | | |
| | BMW region | 60% | | |
| Scheme deadweight | Greater Dublin | 100% | 35% | 10% |
| | Rest of State | 95% | | |
| | BMW region | 90% | | |
| Multiplier – Indirect effects | Use CSO input-output Table | 1.6 | 1.6 | |
| Multiplier – Induced effects | N/A | N/A | 1.6 | |

Table 14: Parameter values

Source: Forfás (2003), Department of Finance, Indecon

The Model

8.40 The Forfás model used by the Department is described in the Box below. A full description is available in Forfás (2003).²⁴ It is assumed that Section 481 SPVs are structured so as to not generate profits. Therefore the profits and tax on profits in the model are assumed to equal zero.

Let

GDW = Grant deadweight

TDW = Tax deadweight

v = Shadow wage rate

Lambda = Proportion of shadow wage rate attributable to immigration

Benefits

B = $[1 - \text{GDW}] * [(1 - v) * \mathbf{B1} + (1 - v) * \mathbf{B2} + \mathbf{B3}]$

B1 = Direct wage bill + Direct Irish profits (both inclusive of taxes)

B2 = Indirect wage bill + Indirect Irish profits (both inclusive of taxes)

B3 = Taxes on direct and indirect foreign profits + $\text{Lambda} * v * (\text{taxes on direct wage bill}) + \text{Lambda} * v * (\text{taxes on indirect wage bill}) + \text{Reduction in deadweight burden of taxation}$

Reduction in deadweight burden of taxation = $\text{TDW} [(1 - v) * \mathbf{T1} + (1 - v) * \mathbf{T2} + \mathbf{T3}]$

T1 = taxes on direct wage bill and on Irish component of direct profits

T2 = taxes on indirect wage bill and on Irish component of indirect profits

T3 = Taxes on direct and indirect foreign profits + $\text{Lambda} * v * (\text{taxes on direct wage bill}) + \text{Lambda} * v * (\text{taxes on indirect wage bill})$

²⁴ See 'The economic appraisal system for projects seeking support from the industrial development agencies', by Murphy, Anthony; Walsh, Brendan M.; Barry, Frank, Forfás, 2003

Costs

$$C = (1 + TDW) * Grant$$

Box 14: Department of Finance Model

Source: Forfás (2003)

Note: Section 481 SPV's are assumed not to generate profits. Therefore the profit and tax on profit lines above are assumed to equal zero

Results of the Department's CBA

Benefits

- 8.41 According to the Revenue/IFB data presented in chapter 3 above, there was €64m in qualifying labour expenditure associated with Section 481 productions in 2011 and €54m in materials and services expenditure. Applying a multiplier of 60% to materials and services expenditure gives total indirect labour expenditure in 2011 of €33m. Summing this with direct labour gives total direct and indirect labour expenditure of €97m.
- 8.42 As described above, not all labour expenditure can be considered as a net benefit, as account must be taken of the opportunity cost of these labour resources, namely the income labour would generate in the absence of the scheme. As explained, a shadow price of 80% is applied to the labour. The total net wage benefit after the application of the shadow price is therefore €19m. This is represented by the expression $(1-v)*B1 + (1-v)*B2$ in the model.

| | | |
|---|--------|-------------|
| Direct Wage Bill | | €64.0m (B1) |
| Materials and services | €54.2m | |
| Apply multiplier of 60% | €32.5m | |
| Indirect Wage Bill | | €32.5m (B2) |
| Total Direct and Indirect | €96.6m | |
| Shadow cost (80%) | €77.3m | |
| Net benefit from wages $(1-v)*B1 + (1-v)*B2$ | | €19.3m |

Table 15: Cost benefit analysis model

Source: Department of Finance analysis

- 8.43 Another benefit is the tax income generated for the exchequer from Section 481 productions and the savings in social welfare payments to Section 481 labour.

- 8.44 Based on the data presented in chapter 3, a total of €21.7m in labour taxation was generated from Section 481 productions in 2011. This is based on Revenue data files on PAYE, PRSI and USC receipts as presented in Table 6 in chapter 3. Schedule D income tax is estimated by the Department based on its estimate of Schedule D income as described in chapter 3 taxed at an effective rate of tax of 34% as per the Indecon submission.
- 8.45 In estimating the social welfare savings the Department accepts Indecon's estimate. A gross social welfare saving of €2.5m is generated based on IBEC's estimate of 1606 FTE employees in Section 481 projects in 2011 and Indecon's estimate of the average annual support payment to single claimant €7791 based on Department of Social Protection data. The total savings are adjusted in line with the Indecon submission to reflect Indecon's view that only 20% of workers would claim social welfare in the absence of the scheme.
- 8.46 A further benefit accrues from the taxation revenues attributable to the €32.5m in indirect labour wages. An effective tax rate of 35%, consistent with the Indecon model, is applied which results in a gross tax benefit of €11.4m.
- 8.47 A gross tax benefit from labour taxation and social welfare savings of €36m is estimated before the application of a shadow price to account for opportunity costs. Based on a shadow price of 80% and a lambda value of 55%, the net benefit from income tax and social welfare is €15.7m. This represents the sum of the first three terms of B3 in the model.

| | | |
|---|--------|--------|
| PAYE | €1.6m | |
| PRSI | €1.7m | |
| Schedule D | €17.8m | |
| USC/Income Levy | €0.7m | |
| Taxes on Direct Wages | | €21.7m |
| Social welfare savings | | €2.5m |
| Indirect wages | €32.5m | |
| @ effective tax rate of 35% | €11.4m | |
| Taxes from Indirect Wages | | €11.4m |
| Gross tax and SW | €35.6m | |
| Shadow cost (80%) * Lambda (55%) | €20.0m | |
| Net benefit from wages after shadow price | | €15.7m |
| Plus VAT | €5.4m | |
| Net tax benefits | | €21.1m |

Table 16: Outputs of cost benefit model

Source: Department of Finance analysis

- 8.48 The last term in B3 in the model represents the reduction in the deadweight effect of taxation arising from additional taxes generated. It includes three terms T1, T2 and T3 with T1 and T2 scaled by the shadow price of labour. The sum of the three T-terms is multiplied by the shadow price of public funds.
- 8.49 T1 is the tax benefit on direct wages and social welfare savings of €24.3m. A shadow price of 80% reduces the net benefit to €4.9m. T2 represents the tax benefit from indirect wages of €11.4m. After the application of shadow price of labour of 80% the net benefit is €2.3m.
- 8.50 T3 adjusts the opportunity cost deductions from direct wage (including social welfare) and indirect wages for 'lambda' (i.e. the immigration component of the opportunity cost) and essentially 'adds back' some of the benefits that were reduced by the shadow cost in T1 and T2. A value of €15.7m is estimated for T3.
- 8.51 The sum of T1, T2, T3 and VAT receipts – which in total equals €28.2m – is multiplied by the shadow cost of public funds to arrive at a value that represents the amount by which the tax distortion on the costs side of the CBA is reduced by as a result of the tax revenue generated by the scheme.
- 8.52 Based on a shadow cost of public funds of 50%, the deadweight burden of taxation is reduced by a €14.1m.
- 8.53 The overall term B3 in the model, the sum of wage taxation after a shadow price deduction, VAT receipts and the term T3 is equal to €35.2m.

| | | |
|--|--------|--------------------|
| | | |
| Tax on Direct Wages (incl. SW) | €24.3m | (T1) |
| Reduce by shadow price of labour (80%) | €19.4m | |
| Tax on direct wages after shadow cost | | €4.9m |
| Tax on Indirect Wages | €11.4m | (T2) |
| Reduce by shadow price of labour (80%) | €9.1m | |
| Tax of Indirect Wages after shadow cost | | €2.3m |
| VAT | | €5.4m |
| Tax on Direct Wages (incl. SW) | €24.3m | |
| Reduce by shadow price of labour (80%) * Lambda (55%) | €10.7m | |
| Tax on Indirect Wages | €11.4m | |
| Reduce by shadow price of labour (77%) * Lambda (55%) | €5.0m | |
| Total adjustment for Lambda | | €15.7m (T3) |
| Reduction in deadweight burden of taxation | | €28.2m |
| Adjust for shadow price of public funds (50%) | €14.1m | |
| Total wage tax (incl. SW) after shadow price of labour | €15.7m | |
| VAT | €5.4m | |
| B3 term | | €35.2m (B3) |

Table 17: Outputs of cost benefit model

Source: Department of Finance analysis

8.54 The total benefits in the model are the sum of the wage benefits B1, B2 (both after a shadow cost adjustment) and a taxation benefit B3. As discussed above the Department has applied an overall scheme deadweight factor of 35%. The total net benefits of the scheme after adjusting for deadweight are therefore €35.5m. The derivation of this estimate is described in the table below.

| | | |
|--|--------|--------|
| Direct wage bill (B1) | €64.0m | |
| Shadow price of labour adjustment B1*80% | €51.2m | |
| B1 after shadow price adjustment B1*(1-v) | | €12.8m |
| Indirect wage bill (B2) | €32.5m | |
| Shadow price adjustment B2*77% | €26.0m | |
| B1 after shadow price adjustment B2*(1-v) | | €6.5m |
| B3 | | €35.2m |
| Total benefits before adjustment for scheme deadweight | €54.5m | |
| Deadweight adjustment (35%) | €19m | |
| Total net benefits | | €35.5m |

Table 18: Outputs of cost benefit model

Source: Department of Finance analysis

Costs

- 8.55 The total net benefits of the scheme, after adjustments for shadow prices and deadweight, must be compared with the overall costs of the scheme. The primary cost of the scheme is the tax foregone. A secondary cost is the scheme administration costs (staff and non-staff) incurred by the Revenue Commissioners.
- 8.56 The gross costs must be inflated to account for the distortionary impacts on society of raising this revenue through other forms of taxation. This adjustment is made using the shadow price of public funds. As stated above, some of the societal cost is taken account of (i.e., reduced) on the benefits side of the CBA from the 'reduction of deadweight burden of taxation' term embedded in the term B3. Accordingly, this adjustment is applied on a consistent basis to both benefits and costs.
- 8.57 The total annual tax costs were estimated in chapter 3. The tax cost for 2011 was estimated at €46.5m. This raw cost does not account for the societal cost of taxation. Based on a shadow cost of public funds of 150%, the welfare cost to society is estimated at €69.8m.
- 8.58 In an earlier study on behalf of the Department of Finance, Indecon estimated the administrative costs of the scheme to be €0.25m in 2006. In its submission on behalf of IBEC it estimated a 2011 cost of €0.28m. The Department accepts this estimate. This estimate must also be adjusted to take account of the cost to society of the taxation required to fund the administrative costs of Section 481. Using a shadow price of public funds the cost is adjusted to €0.42m.
- 8.59 It should be noted that Indecon included an additional cost from Section 481 in its 2007 and 2012 studies relating to the costs associated with the Irish Film Board funding of audiovisual productions. Given that this is a separate funding source to funding provided by Section 481 investors the Department

does not regard it a specific cost of the Section 481 scheme and did not include the costs in its model.

8.60 The net costs to society of the scheme are the sum of the exchequer cost and the administrative costs, after adjustment for the shadow cost of public funds, and are estimated at €70.2m as set out below.

| | | |
|--|--------|--------|
| Tax foregone | €46.5m | |
| Adjustment for shadow cost of public funds (50%) | €23.3m | |
| Net exchequer cost | | €69.8m |
| Administrative costs | €0.28m | |
| Adjustment for the shadow cost of public funds (50%) | €0.14m | |
| Net administrative costs | | €0.42m |
| Total net costs | | €70.2m |

Table 19: Outputs of cost benefit model

Source: Department of Finance analysis

8.61 When the overall net costs of the scheme are compared with the net benefits for 2011, after shadow price and deadweight adjustments, the Department estimates a total welfare loss to society of €34.7m.

| | |
|---------------------|---------|
| Net benefits | €35.5m |
| Net costs | €70.2m |
| Net societal impact | -€34.7m |

Table 20: Outputs of cost benefit model

Source: Department of Finance analysis

Sensitivities around the results

8.62 It is important to test how sensitive the results of any CBA are to changes in some of the key parameters. Whilst the Department's baseline analysis resulted in an estimated net societal loss of €34.7, it is prudent to see how this estimate would change if adjustments were made to the scheme deadweight and the shadow cost of labour factors.

| Shadow price of labour | 100% | 80% | 60% | 50% | 40% | 30% | 20% |
|------------------------|---------|----------------|---------|---------|---------|---------|---------|
| Deadweight | | | | | | | |
| 10% | -€38.2m | -€21.1m | -€4.2m | €4.1m | €12.3m | €20.5m | €28.6m |
| 20% | -€41.8m | -€26.5m | -€11.6m | -€4.2m | €3.2m | €10.4m | €17.6m |
| 35% | -€47.1m | -€34.7m | -€22.5m | -€16.5m | -€10.6m | -€4.7m | €1.2m |
| 40% | -€48.9m | -€37.4m | -€26.2m | -€20.7m | -€15.2m | -€9.7m | -€4.3m |
| 50% | -€52.4m | -€42.9m | -€33.5m | -€28.9m | -€24.3m | -€19.8m | -€15.3m |
| 60% | -€56.0m | -€48.4m | -€40.9m | -€37.2m | -€33.5m | -€29.9m | -€26.3m |
| 70% | -€59.5m | -€53.8m | -€48.2m | -€45.4m | -€42.7m | -€39.9m | -€37.2m |

Table 21: Sensitivity analysis of Department of Finance CBA results

Source: Department of Finance analysis

- 8.63 In the table above sensitivities around the shadow price of labour are read across the rows. For instance under the baseline scheme deadweight assumption of 35%, the second entry in the row of -€34.7m represents the estimate associated with the baseline shadow cost of labour assumption of 80%. Reading across this row gives alternative net outcomes under a range of parameter values for the shadow cost of labour.
- 8.64 As can be seen, a net benefit to society under the assumed level of deadweight only arises if the shadow cost of labour is less than 30%. Given that the Department's estimate was based on Honohan's minimum parameter estimate, a shadow cost of labour of 30% is considered unrealistic.
- 8.65 It can also be seen above that even a very low scheme deadweight of 10% in combination with the baseline cost of cost of labour of 80% results in a net loss to society.
- 8.66 It should be noted that the Indecon assumptions of a deadweight factor of 10% and a shadow cost of labour of 10% would have generated a gain. However these assumptions appear unrealistic and are inconsistent with official guidelines.

Commentary on Indecon Submission

- 8.67 The Indecon CBA estimated total benefits in 2011 of €64.9m and total costs of €58.5m with an overall net benefit of €2.4m. This represents a return from the scheme of 4%.
- 8.68 As discussed above, the Indecon analysis did not account for the distortionary effects of taxation on society and so the overall costs and benefits are not adjusted for the shadow cost of public funds. The Indecon estimates of the overall scheme deadweight and the shadow cost of labour are also significantly below those used by the Department of Finance in its analysis. A further deviation from the Department's approach is the inclusion of a multiplier for 'induced effects'.

- 8.69 The Indecon analysis also included an additional benefit referred to as 'other wider benefits'. These include the cultural benefits of certain indigenous film production activities, the development and retention of skilled creative talents, and also the potential tourism benefits arising through increased awareness of Ireland through film and other productions distributed internationally.
- 8.70 Indecon increased the overall benefits by 25% to account for these benefits, though the rationale for the 25% increase is not explained in its submission. Overall Indecon add a further €12.9m to the scheme benefits to account for 'wider economic benefit'. While not disputing that the relief may give rise to some wider intangible benefits, the Department takes the view that there is no methodology available that would enable a monetary value to be applied to these benefits. Accordingly, it would not be consistent with official guidance to include a benefit of this type in the CBA.
- 8.71 Given that Indecon also include the €8.8m cost of IFB loans which is not regarded by the Department as a cost, it is worth examining what the Indecon estimate would be without either the 'other wider benefit' or the IFB cost. Overall when these inputs are excluded a net cost of €1.7m results. Of course this estimate does not account for shadow prices.

Annex 1: Current Operation of Section 481

Cultural test

- A1.1 In order to qualify for Section 481, a production must pass cultural tests administered by the Department of Arts, Sport and Tourism. This is in common with other European Countries and other State supports for the film industry.
- A1.2 The cultural tests are quite broadly defined and aim to assess whether a production will be an effective stimulus to film making in Ireland and the general Irish economy as a whole. Also assessed is the degree to which and the way in which it will portray Ireland, its culture and the extent to which it will support the development of skills in the Irish workforce.

Qualifying company

- A1.3 A qualifying company for the purposes of the Section 481 is an Irish incorporated and resident company, or a company which is carrying on a trade in the State through a branch or agency. The company must exist solely for the production and distribution of a single qualifying film.²⁵
- A1.4 In general terms the qualifying production company is a Special Purpose Vehicle (SPV). This ensures that the funding is clearly targeted for the production of a specific film so that the investor will be aware of how the investment is to be utilised.
- A1.5 A certificate must be obtained by the company from the Revenue Commissioners and should be obtained in the early stages of production, and no later than when 25% of total production costs have been incurred.

Qualifying production

- A1.6 The production of feature films, creative documentaries, television drama and animation are all considered eligible for Section 481 funding. In contrast to the UK (planned), France and Canada, video game production is effectively excluded from any relief under Section 481.

Qualifying eligible spend

- A1.7 Section 481 allows for relief on qualifying eligible spend which in general terms, allows expenditure on Irish and European labour (EU crew who come to Ireland to shoot) costs and goods, services and facilities that are produced or provided within Ireland.
- A1.8 In contrast with a number of other major film production centres, Section 481 effectively disallows expenditure on labour from non EU countries such as the United States. In practice this means that the costs associated with the main 'above the line costs, such as lead actors, producers, writers and directors may not be considered eligible expenditure in certain cases.
- A1.9 As an investor led scheme which requires that investor funds are matched to production costs, Section 481 identifies projected expenses at the early stages of the production and mandates that amount raised under Section

²⁵ Film Relief IT57, Revenue Commissioners

481 should be invested and made available to the production company from the outset i.e. before commencement of principal photography / first model movement, as the case may be, or where this is not possible, at the latest before 25% of the total production budget has been incurred. In certain cases, productions may be extended or costs may overrun.

A1.10 Under Section 481, in contrast to a Tax Credit / Deduction based system, it is difficult to include these additional costs in eligible expenditure. This has previously caused difficulties where productions were extended or there were unforeseen cost overruns.

A1.11 There are a number of key conditions governing any investment in Section 481 companies, including the qualification of relevant films, companies, and investors. In order to claim Section 481 film relief the following key milestones require completion:

- A Special Purpose Vehicle (SPV) must be established by the qualifying companies, and a Revenue Commissioners tax certificate must be obtained by the SPV prior to any fundraising.
- An application for a certificate under Section 481 should be submitted to the Revenue Commissioners at least 21 days prior to the earlier of:
 - (i) Commencement of the raising of relevant investments; or,
 - (ii) Commencement of the principal photography, the first animation drawings or the first model movement, as the case may be.

Participation

A1.12 To be eligible for Section 481, the production company must provide the Revenue Commissioners with the relevant agreements between production companies, letters of intent in relation to other financing and any details of the relative flows of funds between the relevant parties. The Revenue Commissioners will also require details around any relevant completion bonds and agreements.

Financial incentives

A1.13 The following describes the key financial aspects of the relief as currently structured:

- **Individual investors** can invest up to €50,000 under the scheme in any year of assessment with carry forward of any unrelieved investment
- **Corporate investors** can invest up to €10,160,000 in any 12 month period with a cap of €3,810,000 in any one film, (any excesses only to be invested in productions with a budget of €5,080,000 or less). Companies can claim 80% relief on their investment.
- Qualified production companies can raise up **to 80% of the total production cost**, on an **upfront basis**, up to a budget **limit of €50m** through Section 481.
- There is no capping on the level of industry-wide tax relief which can be provided in a given year under Section 481
- A cap on qualifying expenditure for a single productions is set at €50m
- The total value of Section 481 funds raised is capped at 80% of the total cost of production

- An application for Section 481 cannot be made after 25% of production budget has been incurred
- Budget overruns cannot qualify as eligible expenditure
- A considerable amount of 'above the line costs' may not be considered to be qualifying expenditure
- Individual investors can invest no more than €50,000 per year

Box 15: Key financial aspects of Section 481

Source: Department of Finance, Revenue Commissioners

Annex 2: Irish Film Board and BAI Funding

A2.1 The IFB provide funding for training, and the development, production and distribution of projects.

Development

A2.2 Development covers screenplay, project development, and animation development.

Film Screenplays

A2.3 Funding is provided in the form of loans which are repayable on the first day of principal photography of the developed film. The loan does not carry interest, no premium is charged at the time of repayment, and BSÉ/IFB does not receive a profit share in return for its development funding. Screenplay Development Loans are of fixed amounts: €12,000 where a writer is the sole applicant and €16,000 where a team of two or more writers is applying or where a writer and director apply together.

Project Development

A2.4 This includes both film and high quality TV drama. Funding is provided in the form of loans which are repayable on the first day of principal photography of the developed film or TV drama. The loan does not carry interest, no premium is charged at the time of repayment, and BSÉ/IFB does not receive a profit share in return for its development funding. Project Development Loans may be drawn down in stages, subject to progress. The maximum amount that can be drawn down at any one time is €50,000; the maximum total amount that BSÉ/IFB can provide to any one project is €100,000. Any amount of development funding above €50,000 provided to a project must be matched by funding from other sources.

A2.5 Development funding will be awarded to TV drama projects where the development is also receiving equivalent funding from an established national or international broadcaster.

Animation

A2.6 Same method of funding as for project development but loan becomes repayable on full animation drawing of the developed film or TV series.

International development projects

A2.7 The objective is to assist Irish writers, producers etc. to attract international projects here. Funding is provided in the form of loans which are repayable on the first day of principal photography of the developed project. Funding will only be provided where there is equivalent funding in place from a recognised national or international broadcaster. The involvement of an Irish producer (who will be the applicant to BSÉ/IFB) as a bona fide co-producer is required as well as other stipulations requiring significant Irish personnel involvement.

Production

Irish Productions

A2.8 Funding is provided in the form of limited-recourse loans recoverable from a share of revenues from exploitation of the film or television series entitling BSÉ/IFB to a share of net profits. An approved completion bond is a normal requirement by BSÉ/IFB where its funding is to be made available during production. The appointment of a collection agent is also normally required.²⁶

Documentaries, Animation, Co-produced & Internationally produced projects

A2.9 These areas have similar funding requirements as the above paragraph. Co-produced projects where an Irish producer is teaming up with non-Irish producers as well as internationally produced projects where substantial production is taking place in Ireland are eligible with for same with extra stipulations.

Completion Funding

A2.10 Funding to enable the completion of a fiction film, animation or documentary (but not a TV drama or short film) which has reached post-production stage or later without BSÉ/IFB support, but which has run out of money. BSÉ/IFB Completion funding is generally provided during the remaining stages of production in accordance with an agreed cash flow and a full cost report is required.

Distribution

A2.11 Funding for *bona fide* Irish distributors to help defray the costs of theatrical release in Ireland (including Northern Ireland) of feature films already in receipt of BSÉ/IFB production funding, and to stimulate more effective publicity and promotion in support of their release.

Marketing Support

A2.12 Funding is now available in the form of non-repayable grants, in order to accelerate the flow-through of returns from the Irish market to production investors and producers

A2.13 The costs of publicity and promotion of qualifying films in the Irish market are considered as eligible costs under the scheme. Distributors may apply for Marketing Support funding to cover 90%, up to a maximum of €75,000, of the following costs:

- Media space costs: TV, press, radio, outdoor, online;
- Publicity costs: media screenings, talent visits, festivals in Ireland; and (to the extent not provided by the production) stills/clips/EPK for editorial use;
- PR agency fees, if work not handled in-house and if approved by BSÉ/IFB; and,
- Promotional costs: trailer design and edit, website, talker screenings, special promotions, manufacture and distribution of merchandise for promotional use only.

²⁶ Limits on the amounts awarded by the IFB can be accessed here:
http://www.irishfilmboard.ie/funding_programmes/Regulations_Limits/40

Direct Distribution

A2.14 The following costs are eligible for Direct Distribution support:

- Costs of release prints;
- Trailer design and creation;
- Creative and production costs of key art, posters, and advertising;
- Censorship submission;
- Media space costs; and
- Marketing, publicity and promotional costs.

A2.15 Direct Distribution funding is capped at 80% of the total distribution budget, up to a maximum amount of €15,000. The funding is structured as a loan, recoverable from theatrical revenues, but not revenues derived from DVD, VOD and TV exploitation.

Print Provision for theatrical and festival release

A2.16 For the creation of a Digital Cinema Package (DCP for short and feature length films. Funding is available to cover the cost of processes entailed in creating a DCP of a film that is otherwise completed. This may include the technical costs and associated soundtrack costs, but may not include any other completion processes, clearances, fees, etc. This funding can cover the cost of up to 20 prints of a film made under one of BSÉ/IFB's short film schemes, or up to 10 prints of a film not made under a scheme but already in receipt of Festival Prints funding. This is directed at assisting with the theatrical release of the film as well as festival screening.

Broadcasting Authority of Ireland Funding

Sound and Vision II scheme

A2.17 This scheme is designed to provide funding for television or sound broadcasting programmes including feature films, animation and drama on statutory outlined themes of

- Irish culture, heritage and experience
- Adult Literacy or Media Literacy
- Irelands context in Global affairs

A2.18 Factual and fictional programming including but not restricted to: documentaries; educational programmes; drama productions; feature films; and, animation;

- One-off programmes (short or feature-length) and multi-episode projects (series or serials); and,
- Programmes targeted at the general public or towards a specific audience (e.g. children)

A2.19 The ratio of television and radio funding currently stands at 80%:20%. This is as a result of the high cost differential between television and radio production.

A2.20 The BAI allocates grants under Sound & Vision II that represent up to 95% of the production costs for the programme. Applicants are required to provide full details regarding the level and source of other funding for both the development phase, and the contribution to the production budget

| Minimum Award | Maximum Award | Grant awarded will not represent more than the following percentage of the total budget |
|----------------------|---------------|---|
| | €20,000 | Up to 95% |
| €20,001 | €40,000 | Up to 90% |
| €40,001 | €55,000 | Up to 85% |
| Greater than €55,001 | | To be negotiated on a case by case basis |

Table 22: Sound and Vision II funding of radio programmes

Source: Broadcasting Authority of Ireland

| Minimum Award | Maximum Award | Grant awarded will not represent more than the following percentage of the total budget |
|-----------------------|---------------|---|
| | €50,000 | Up to 95% |
| €50,001 | €250,000 | Up to 90% |
| €250,001 | €750,000 | Up to 85% |
| Greater than €750,001 | | To be negotiated on a case by case basis |

Table 23: Sound and Vision II funding of television programme and film production

Source: Broadcasting Authority of Ireland

A2.21 It is required that the film qualifies as low-budget in order to receive State Aid funding above 50% of the total budget. It's the BAI's view that the amount of funding for programmes under the matrices above would be regarded as low, and therefore qualifies for the exemption to State Aid rules.

A2.22 The BAI retains the right to introduce a recoupment clause in any contract made under the scheme where a sizeable grant has been approved to a programme or series of programmes that might reasonably be expected to make a significant profit. All recouped funding will be re-assigned directly into the Broadcasting Fund and will be available for further disbursement.

Annex 3: Summary Table of Submissions

| Submission | 1. Is the exchequer's supports to the film and TV sector in Ireland through section 481 relief an efficient use of scarce resources and if so why? | 2. Is the current scheme maximising the potential economic benefits to Ireland in terms of stimulating activity in the film and TV sector, if not why not? | 3. What are the economic arguments for restricting or terminating the scheme? | 4. What possible changes to the existing scheme, if any, should be considered and why? | 5. Do interested parties agree there is merit in extending the S481 Film Relief Tax incentive scheme beyond 2015? If yes, why? If no, why not? | 6. How does the scheme interact with other enterprise tax incentives such as the BES/EII? |
|-------------------------|--|---|---|---|--|--|
| Irish Film Board | S481 is successful due to its transparent, well understood system which is responsive to demand and supports indigenous producers. In addition it has low levels of displacement and deadweight as well as maximising spend in Ireland. They also identify the possible role an expert group could play in a forward looking assessment of where supports for films could go in the future | S481 focuses on stimulating activity in Ireland. The level of deadweight is low at less than 15% and leakage from the scheme is low in that 28% of the 41% relief goes straight to producers. Tax Credits and Grant systems are not considered as desirable alternatives. | Elimination of the scheme would eliminate the vast majority of the industry and also limit opportunities that are possible in Gaming. | S481 has the capacity to provide further support to the broader AVP sector in terms of digital production and Gaming. | Endorsement of continuance of the relief to provide certainty to the market. | Highlight the possible role that EII relief and R&D tax credit scheme could have for the film industry |

| Submission | 1. Is the exchequer's supports to the film and TV sector in Ireland through section 481 relief an efficient use of scarce resources and if so why? | 2. Is the current scheme maximising the potential economic benefits to Ireland in terms of stimulating activity in the film and TV sector, if not why not? | 3. What are the economic arguments for restricting or terminating the scheme? | 4. What possible changes to the existing scheme, if any, should be considered and why? | 5. Do interested parties agree there is merit in extending the S481 Film Relief Tax incentive scheme beyond 2015? If yes, why? If no, why not? | 6. How does the scheme interact with other enterprise tax incentives such as the BES/EII? |
|---------------------------------|--|---|--|--|---|---|
| Screen Producers Ireland | Industry in Ireland yields a net gain to Ireland, provides significant employment, attracts mobile inward investment into Ireland, and contributes to tourism in Ireland and the development of our culture. | Early receipt of funds an essential advantage over other country's reliefs. It also benefits both experienced and inexperienced producers alike as well as attracting more risk-willing funding than banks might otherwise provide. | Eliminating the relief would severely damage the industry especially in light of the competition from other jurisdictions such as the UK. If the scheme was terminated the cost in terms of lost jobs and unemployment benefits would be high. | The rule that S481 funding should be provided to production company should be before 25% of the production budget is spent, that commencement of the film should begin 21 days after application to the Revenue Commissioners, and that the issuance of the compliance report's reliance on information on total cost of production should be ended. | Yes. Support for the sector is consistent with the National Recovery Plan. Creative Capital report identifies the growth of the AVP sector as something that hinges on the relief extending out to 2020. Cites the recommendation for a 7 year extension in the Report on the Strategic Development of the Irish Film and TV Industry | The scheme does not interact with other enterprise tax incentives. |

| Submission | 1. Is the exchequer's supports to the film and TV sector in Ireland through section 481 relief an efficient use of scarce resources and if so why? | 2. Is the current scheme maximising the potential economic benefits to Ireland in terms of stimulating activity in the film and TV sector, if not why not? | 3. What are the economic arguments for restricting or terminating the scheme? | 4. What possible changes to the existing scheme, if any, should be considered and why? | 5. Do interested parties agree there is merit in extending the S481 Film Relief Tax incentive scheme beyond 2015? If yes, why? If no, why not? | 6. How does the scheme interact with other enterprise tax incentives such as the BES/EII? |
|--|--|--|---|--|--|---|
| Irish Taxation Institute | Identify reports which calculate a net benefit to the state from S481 as well as cultural and creative development as well as tourism. Highlight that the S481 model compares favourably with the tax credit and direct subsidy methods of support to the sector. | Giving a 10 year guarantee of the scheme's existence would improve the economic benefits as it would allow films with a long lead in time to plan ahead for production in Ireland. | No arguments for restriction of the relief given the net benefit to the state as well as employment of labour skills which have no demand elsewhere in the economy such as construction. In addition strong competition from the UK would put our industry at a disadvantage without the relief | Extend the scheme for a longer period as well as maintain competitiveness with the UK | Yes. | No interaction with the EII. A change in the S481 closer to the workings of the EII scheme would be unworkable for the industry |
| Screen Directors Guild of Ireland | S481 contributes significant sums of expenditure in the economy, employment, support the learning and development directors and producers in the industry, finance culturally important films in the industry and in general support art and creativity in Ireland | Provides a vital source of finance to the industry as well as employment. | Feel the relief works well and does not merit termination | Encourage the use of and Irish director on S481 productions as well as extend the relief to Video Games. | Should extend the relief as long as is practicably possible | X |

| Submission | 1. Is the exchequer's supports to the film and TV sector in Ireland through section 481 relief an efficient use of scarce resources and if so why? | 2. Is the current scheme maximising the potential economic benefits to Ireland in terms of stimulating activity in the film and TV sector, if not why not? | 3. What are the economic arguments for restricting or terminating the scheme? | 4. What possible changes to the existing scheme, if any, should be considered and why? | 5. Do interested parties agree there is merit in extending the S481 Film Relief Tax incentive scheme beyond 2015? If yes, why? If no, why not? | 6. How does the scheme interact with other enterprise tax incentives such as the BES/EII? |
|-------------------------------|--|---|---|---|--|--|
| Animation Ireland | Yes the scheme satisfies the requirements set out in the Commission on Taxation 2009 in that it attracts mobile investment, is efficient, stable, simple, and satisfies the principle of equity. They recommend that we increase the tax wedge of the scheme while leaving the overall scheme unchanged. | Recommend increasing the % of Irish spend that can be funded by s481 in order to attract more international investors to Ireland. In addition, to change the Irish spend rules so that non-E.U residents who work on the production and pay Irish Income tax should be considered eligible Irish Spend. | Recommended to extend the scheme to gaming companies. Extend the 25% rule with greater flexibility on budget increases and renegotiation of contracts to allow for additional raising of S481 funding for these purposes. | Recommend not restricting or terminating the scheme | Recommend extending S481 out to 2020 | Extend EII schemes to AV companies both content/IP creation and development and capital expenditures on production facilities. Extend the R&D Tax Credit for expenditures no intellectual property creation in the audio visual sector |
| Audiovisual Federation | Cite Indecon's findings of a net gain to the exchequer in 2011 of 2.4 million euro. | S481 is considered crucial to the ability of the industry to take advantage of future international growth in the industry | No arguments for restricting the relief | Recommends a joint Dept. of Finance/industry working group be set up to evaluate possible changes to the industry | Supports it's extension out to 2020 | Not in a position to comment |

| Submission | 1. Is the exchequer's supports to the film and TV sector in Ireland through section 481 relief an efficient use of scarce resources and if so why? | 2. Is the current scheme maximising the potential economic benefits to Ireland in terms of stimulating activity in the film and TV sector, if not why not? | 3. What are the economic arguments for restricting or terminating the scheme? | 4. What possible changes to the existing scheme, if any, should be considered and why? | 5. Do interested parties agree there is merit in extending the S481 Film Relief Tax incentive scheme beyond 2015? If yes, why? If no, why not? | 6. How does the scheme interact with other enterprise tax incentives such as the BES/EII? |
|------------------------|---|--|--|--|--|---|
| Crowe Horwath | Note that the current system compares favourably with the other options of support to the film sector around the world i.e. direct subsidy and tax credit. They note that S481 investment is not low risk but due to quality of due diligence | S481 encourages reinvestment and promotes longer participation by foreign producers | Should not be eliminated | Identify that a tax credit system is not desirable because of the requirement to heavily discount it by a bank as well as not a good mechanism for supporting smaller producers. The 25% rule for submitting for S481 funding should be abolished especially in the case of animation and post production work | Yes, it should be extended over the longer term | No interaction with the EII scheme |
| Ardmore Studios | Allows Irish production companies to compete internationally. | Consider that the relief contributes to Ireland economically and culturally and reason that this will continue to grow in line with growth in the industry | They cite that there may be short-term arguments to limiting the relief but it would hamper our long run prospects of competing in the industry. | There should be an additional return for return investments such as for an additional season in a TV series | Yes, we should increase the term of the relief to 2020 | EII should be extended to audiovisual companies |

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| Brendan Rehill | Yes, it provides important opportunities for indigenous Irish talent to become involved in the industry | X | No | Extend the scheme to provide certainty | Should not be eliminated | X |
| Brown Bag Films | Allows Irish production companies to compete internationally. | No it's not keeping up with film support developments in other jurisdictions | X | Should be able to adapt to new business models, as well as extend it to film investors. Allow for contract closing to occur without restriction to greater than 25% of total budget not being spent | Yes, it should be extended over the longer term | |

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| Deasy Advisory Services | The scheme could contribute more to the industry by increasing the amount of money going to content producers | A tax wedge would yield more money for producers of content in the industry | The scheme should not be restricted or eliminated | Include the USC in the relief or increase the level of expenditure that qualifies for relief to above 100% | Extend the relief out to 2020 | EII and R&D tax credit's should be extended to the industry |
| Dublin City Business Association | Brings foreign revenue into the centre of Dublin and has long term impacts on tourism | X | Scheme should not be terminated | X | Strongly support the extension of the scheme beyond 2020 | |

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| Games Ireland | S481 not currently suited to the business models used by the gaming industry | X | X | X | X | X |
| Institute of Art, Technology and Design | Supports employment in the industry | The scheme has been very beneficial for providing employment for graduates | X | X | The scheme should be extended beyond the 2015 deadline | X |

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| Irish Playwrights' and Screenwriters' Guild | The scheme is working out ok and has increased in importance due to reductions in other supports to the film industry but has the potential to contribute far more in the future. An increase in the volume of production supported by government would have an increasingly positive effect on the industry. | Maximising the benefits of the scheme requires a long-term commitment to the relief as well as increased volume which will aid in retaining human capital | Eliminating the relief would be to abandon the prospect of having a credible AV industry in Ireland | S481 should be able to respond to the possibility of production for direct distribution in the industry. Extension of R&D tax credits to gaming companies would provide an employment source for writers and actors | Believe in the extension of the relief beyond 2015 | BES/EII has little application to the film industry |
| Jim O'Hanlon | S481 is an efficient use of resources and is far better than other possible support mechanisms used in other jurisdictions | Could attempt to increase the proportion of the benefit which goes to producers | Elimination of the scheme would devastate the industry | Any change should be marginal rather than fundamental due to the difficulties industry has in responding to significant changes in support schemes. There could be a combined tax relief scheme with Northern Ireland and the Republic of Ireland | Yes it should be extended well in advance to provide certainty for the industry | X |

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|---------------------------|--|--|---|--|--|---|
| Octagon/World 2000 | X | X | X | X | X | X |
| Telegael | S481 provides benefits for non-urban production companies which is in line with the Government's spatial strategy | Ireland needs to be cognisant of the changes in the UK's supports given their competitive position in relation to Ireland | The Scheme should not be eliminated | S481 funding should be allowed to be raised in the event of a renegotiation of the contract with commissioning company | Extend the relief to 2020 | No interaction |

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|---------------------------------------|--|--|--|--|--|---|
| Tom Dowling | Yes there has been a significant return on investment from the scheme. The scheme should include more transparency in how the money is spent | Benefit could be maximised if the scheme exercised more control over spending items focusing the spending on actual production activities | If the scheme is eliminated Ireland will be at a serious disadvantage to foreign jurisdictions | Support animation and gaming industries | Yes the scheme should be extended so that producers have time to plan long productions | X |
| Windmill Lane and Screen Scene | S481 allows Ireland to compete on an international basis | X | X | X | Retains the relief beyond 2015 | X |